

**Public hearing – Canberra
8 April 2008**

Time: 1pm – 5pm

Address: Rydges Lakeside
London Circuit, Canberra

Room: Lake Huron

Witness	Submission	Summons
Koundouris Group Mr Theo Koundouris Owner Mr Eric Koundouris Owner Mr Hank Spier Spier Consulting	35	No
Pace Farms Mr Paul Pace General Manager	N/a	Summoned and compelled to appear by ACCC
Australian Beef Association Mr John Carter Mr Athol Economou	44 & 146	No
National Farmers Federation Mr Charles McElhone Manager – Economics Mr Charles Burke Vice President	137	No
Southern Sydney Retailers Association Mr Craig Kelly	3, 10, 108, 136, 141, 150	No

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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: RIDGES HOTEL, CANBERRA

DATE: 1.00 PM, TUESDAY, 8 APRIL, 2008

CHAIRMAN SAMUEL: Good afternoon, everyone. My name is Graham Samuel. I'm the Chairman of the Australian Competition Consumer Commission, and the chair of this public inquiry into the competitiveness of retail prices to standard groceries. I welcome you all and declare this hearing opened.

I'm joined by Commissioner John Martin and Commissioner Steven King, who are the other two presiding members for this inquiry.

The hearing's convened under part 7A of the Trade Practices Act 1974. It's held pursuant to a request from the Assistant Treasurer, Minister For Competition Policy and Consumer Affairs, Minister Chris Bowen, 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 national competition at the supply, wholesale and retail levels 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 the supply chain for standard grocery items; any impediments to efficient pricing of inputs along the supply chain; and, finally, 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 that the ACCC has so far received over 150 public submissions to the inquiry, as well as the number of 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 the 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.

Some of the material covered in the hearing sessions will be confidential and commercially sensitive and, therefore, parts of the hearings will not be open to the

public. Questioning will start in public, but sessions will move into a confidential phase when the question moves on to confidential material relating to the witness.

5 The ACCC has to be able to investigate issues that are commercially sensitive to witnesses, without damaging the witnesses' competitive position and commercial relationships. The ACCC will be questioning organisations about their commercial relationships and about confidential documents the ACCC has obtained through using its information gathering powers.

10 This cannot occur in public. In particular, where a witness has not made any submissions to the inquiry and has been summonsed by the ACCC to attend these hearings, the ACCC must be able to hear certain evidence in confidence. Transcripts of the public parts of the hearings are placed on the ACCC's website. The ACCC
15 may disclose some aspects of the confidential components of the transcript a while after the hearing if it considers that some of the material should be in the public domain, but the ACCC will consult with the relevant witness before doing that. Where there are industry associations or representative organisations who are attending voluntarily, it's more likely that most of the hearing sessions will be in
20 public.

Now, in terms of procedural issues, all witnesses will have received a document that outlines how we intend to approach these hearings, and I'll not go through the procedural points in detail. I just wish to emphasise that although we are not taking
25 evidence under oath at this hearing, it is a serious offence to give false or misleading evidence to the ACCC.

A transcript of the proceedings, apart from any proceedings that are held in private at the inquiry, will be made available on our website.

30 Now, as I indicated before, we recognise 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 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'll then
35 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 hearing, witnesses will be questioned by the ACCC's internal lawyers.

40 Well, that concludes my preliminary marks. I thank all the witnesses that are attending the hearings, particularly those that have been summonsed to attend. We realise you are busy people and attending these hearings can be a significant imposition on you and your organisation.

45 The first witnesses represent the Koundouris Group. Gentlemen, can I ask you to, for the record, state your name and role with respect to the group.

MR E KOUNDOURIS: I'm Eric Koundouris, Managing Director of the Superbarn Group and also the Koundouris Group.

5 MR T KOUNDOURIS: Theo Koundouris, Director of Superbarn and General Manager also.

MR SPIER: And Hank Spier, a consultant to the Koundouris Group.

10 CHAIRMAN SAMUEL: Thank you. I note again 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 with that which the evidence is misleading. Do you all understand that?

15 MR T KOUNDOURIS: Yes.

CHAIRMAN SAMUEL: Thank you. Over to you, Mr O'Donovan.

MR O'DONOVAN: I understand you want to make a brief opening statement.

20 MR E KOUNDOURIS: Yes.

MR O'DONOVAN: And we'll provide you with an opportunity.

25 MR E KOUNDOURIS: Thank you for that. Thank you for inviting us here today. For the purposes of this hearing, we represent the Superbarn Supermarket Group, one of the very few independent full-serviced supermarket groups in Australia. We are a family company.

30 Superbarn is the single largest private sector employer in the ACT, and with approximately 800 people on staff. Superbarn offers direct competition to the two major supermarket chains, in line with the publicly expressed objectives of the Australian Competition and Consumer Commission. In doing so, it also provide a far broader variety of choice to the community.

35 We are Canberra based, but also operate in Sydney, and are keen to expand in the region and further. We have looked at sights in Queensland. However, we are constantly constrained in our expansion plans by the supermarket majors.

40 Just this week we have been gazumped by Woolworths in relation to the purchase of an existing small supermarket in Queanbeyan, one which we had planned to expand into a full-serviced store. Your merger staff is investigating, and we are truly hopeful that the ACCC takes action. We understand that Woolworths will not be able to close the deal until you make your decision, and that will take at least six weeks.

45

We were also interested in the Charnwood and Jindabyne AGA stores, but again got gazumped by Woolworths. I find that sort of action really hurts us and consumers, because Woolworths has stores in areas already.

5 Our submissions outlines other such issues. Our goal is to expand in retailing, and if not, we might have to rethink our goals. We see ourselves as the real competitor to the majors, we successfully compete with them on price, service and quality.

10 On the issue of price, we, as a family company, will often sacrifice the bottom line in order to compete. As stated earlier, sites are critical - old and new ones. In the ACT, Aldi purchase sites via the direct sale policy of the ACT Government, to expand and increase competition. Other State governments should follow this example to allow full-line independents to enter the market and create competition.

15 In my view it is essential that, one, independent supermarkets should be encouraged to develop and expand. Planning authorities should take competition issues into account in its planning decisions on any new supermarket developments. Crucial, as part of such planning policy, the supermarket majors should not be allowed to open any other stores in a geographic area where they already have a store. Where the
20 majors already have more than one store in such a geographic area, they should be required to divest to a new entity.

In saying this, we are not asking for special rules or subsidies or the like. I understand that entry is one of the hallmarks of a competitive market, and we want to
25 do just that. Thank you.

MR O'DONOVAN: All right, you've given us a brief introduction to the Koundouris Group. Can I just get you to describe the full range of activities that the
30 Koundouris Group undertakes?

MR E KOUNDOURIS: In its supermarkets?

MR O'DONOVAN: No, both.

35 MR E KOUNDOURIS: Both. We have two parts to our group. One is we are property developers, and at the same time run the retail chain Superbarn supermarkets. We have found that the only way we can grow our chain is through our development arm - that is, to purchase smaller sites and purchase property
40 around them, and redevelop that area where the final outcome would be a full-blown supermarket. Woolworths or Coles or anyone else is not going to sell us a full-blown supermarket, so we need to manufacture them, and it's crucial that we have the development arm in order to expand.

MR O'DONOVAN: Would you have been able to expand your supermarket
45 business without the development side of your business?

MR E KOUNDOURIS: I can't see how we would do that, no.

MR O'DONOVAN: Okay, all right. Now, and your role within the group involves you in both the development and the supermarket - - -

MR E KOUNDOURIS: Correct.

5

MR O'DONOVAN: - - - side of things.

Okay. Now, could you just give us a brief history of your entry into the supermarket business, so just starting at the very beginning. What's the first store that you acquired, and when was that?

10

MR E KOUNDOURIS: We acquired, in December '91, an independent store that was struggling in the Canberra Centre - which was then known as the - I think it was known as the Canberra Centre, the old Monaro Mall.

15

Previously there was a Coles store there. When they were offered the new location, they declined. It was given then to an independent, who got into difficulty. We purchased that store from that independent. We subsequently combined with other - three other stores that had similar sizes - in other words, could offer the total offering of a full-line supermarket, and collectively we used our buying power in order to be able to compete.

20

Subsequently, our partners in that co-op were bought out by Woolworths and Coles, and we were left on our own, and then started off again in creating what we now have, which are four full-blown supermarkets - three in Canberra, one in Sydney, and we have under planning two more in Sydney, but that process is very, very slow.

25

MR O'DONOVAN: Okay. So in terms of the sequence, you started off with the Civic store.

30

MR E KOUNDOURIS: Correct.

MR O'DONOVAN: And that's, I suppose - although it operates at a different site - that store is still operating, there is still a Superbarn store in Civic.

35

MR E KOUNDOURIS: Correct. It's just double in size to what it was originally.

MR O'DONOVAN: And how many square metres, roughly, is it?

40

MR E KOUNDOURIS: 3,500.

MR O'DONOVAN: And in terms of the service that it offers, could you just briefly describe the range of products that it stocks and sells?

45

MR E KOUNDOURIS: Yes. We have all departments you'd expect to find in a full-line supermarket, from fresh fruit and vegetables, deli, meat, bakery, groceries, liquor, general merchandise, the lot.

MR O'DONOVAN: So it's a full-service supermarket.

MR E KOUNDOURIS: Absolutely, and we do carry approximately 4,000-6,000
5 lines more than our major competitors Woolworths and Coles, as a point of
difference.

MR O'DONOVAN: Okay. So it has a broader range.

MR E KOUNDOURIS: Correct.
10

MR O'DONOVAN: In terms of the sequence, what was the next store that you
acquired?

MR E KOUNDOURIS: I think we purchased a July store in Kaleen, a local group
15 centre.

MR O'DONOVAN: And can you tell us, was that a large format supermarket when
you bought it?

MR E KOUNDOURIS: No, it was what we call a dry store. It was about 1,000 to
20 1200 square metres. The majors, I understand, were also interested in purchasing it,
but we were successful in acquiring this store because the landlord of the premises
had first right of refusal on the business, and we bought that first right of refusal off
him.

MR O'DONOVAN: So, under - - -
25

MR E KOUNDOURIS: Sorry, subsequently we enlarged that, expanded that centre,
that section, to grow that into a full-blown supermarket, and it's still there today, of
30 over 2,000 square metres.

MR O'DONOVAN: Now, absent that option of the landlord's to acquire the
business, do you think it's likely you would have been able to obtain it?

MR E KOUNDOURIS: We'd have no chance at all.
35

MR O'DONOVAN: Who would have acquired it?

MR E KOUNDOURIS: Either Woolworths or Coles. Most likely Woolworths.
40

MR O'DONOVAN: Okay. All right. And then your next store?

MR E KOUNDOURIS: We then similarly bought a Jewel store in the break-up of
that chain in Five Dock Sydney. Again, it was similar to the Kaleen experience, in
45 that it was a dry store. We then purchased - - -

MR O'DONOVAN: And when you say a "dry store", you mean it did not have fresh fruit and veg?

MR E KOUNDOURIS: Groceries only. Pretty well no fresh - or very little fresh.
5 We then acquired, at a premium, the premises that - this was a single free-standing store. We then acquired further land surrounding that in order to - we then went and made a major development in excess of \$30 million, which comprised the supermarket, we built a library for the local council, car parking and 102 apartments over the top, because the cost of acquiring the land, you need to find another use,
10 otherwise it just becomes too uneconomical to make it happen.

MR O'DONOVAN: Sure. So the conversion of it into a large format supermarket was facilitated by the development arm of your group?

15 MR E KOUNDOURIS: Correct.

MR O'DONOVAN: Okay. All right. And then after the Five Dock store?

MR E KOUNDOURIS: We more recently acquired a small AGA in the group
20 centre of Wanniasa. Again, we purchased the freehold - purchased surrounding freehold, rebuilt the whole premises to a large-blown supermarket.

MR O'DONOVAN: Sure. Now, was that acquired at a public auction, the free - - -

25 MR E KOUNDOURIS: No, privately.

MR O'DONOVAN: Private. And how is it that you were able to obtain that site?

MR E KOUNDOURIS: We knew the AGA owners of the previous, and they said to
30 us that Coles was interested in buying the premises. We outbid Coles in that situation.

MR O'DONOVAN: Sure. Okay. And - - -

35 MR E KOUNDOURIS: Plus I should add that they were more interested in selling to us than to Coles in this instance.

MR O'DONOVAN: Right. Did you have any - did they ever say why they were
40 more interested in selling to you.

MR E KOUNDOURIS: Because they disliked them as competitors, I guess.

MR O'DONOVAN: Right.

45 MR T KOUNDOURIS: We also had to buy the premises in that instance as well.

MR E KOUNDOURIS: Yes, I said that.

MR O'DONOVAN: Right. And was it necessary to undertake development of that site?

MR E KOUNDOURIS: Yes, otherwise it couldn't be a full-blown supermarket.

5

MR O'DONOVAN: Right. And so again all of these supermarkets operate a large format with a range of fresh - - -

MR E KOUNDOURIS: Yes.

10

MR O'DONOVAN: - - - fruit and groceries.

MR E KOUNDOURIS: We made the decision a long time ago where many small families decided to go the AGA path or the convenience store path, we thought that it was time someone took on the big boys, if you like.

15

MR O'DONOVAN: Right. So in terms of the market - the point at which you aim your supermarkets at exactly the same market as Coles and Woolworths.

MR E KOUNDOURIS: Absolutely.

20

MR O'DONOVAN: Okay. All right. Now, in addition to those four stores which it currently is operating, are there any other development proposals you have in the pipeline, or close to completion?

25

MR E KOUNDOURIS: We have just got DA approval to do, again, a development. In this instance, Woolworths was there ahead of us. We went direct to the owners for the land and offered them a partnership in the land, and purchased the other half at a premium - again, in order for them to exclude Woolworths and include us, if you like, and then we just had DA for a full-blown supermarket; again, which will comprise basement parking, supermarket, and two upper floors of offices.

30

MR O'DONOVAN: Right. And is the location of that public?

MR E KOUNDOURIS: Yes, it's at Rocky Point Road, Sans Souci.

35

MR O'DONOVAN: So that's in Sydney.

MR E KOUNDOURIS: Yes.

40

MR O'DONOVAN: And any other developments that are public.

MR E KOUNDOURIS: We have currently a DA before the Sutherland Shire Council. It's Crescent Avenue, Sutherland, for a store there as well.

45

MR O'DONOVAN: Okay. And how were you able to obtain that site?

MR E KOUNDOURIS: We purchased the land again. We tried to do a complete redevelop, but weren't successful in acquiring additional land that was required as part of the control plan of the council. The owners of the property - sometimes we need to purchase and deal with anything from three or four, up to 16 or 17 different
5 people in order to put aside for a footprint large enough together, to accommodate our full-blown store, and, of course, land in Sydney is not readily available, and is certainly not cheap and, of course, we can't talk people to sell, irrespective of what we offer them.

10 MR O'DONOVAN: And was it - were any of the major supermarkets interested in that site?

MR E KOUNDOURIS: Yes.

15 MR O'DONOVAN: And so - but you were able to outbid them, is that - - -

MR E KOUNDOURIS: I think we were able to act quickly, and go unconditional in the purchase of the land, and one we got - purchased one site, then obviously that gave us a foothold.

20 MR O'DONOVAN: And in terms of - so since 1991 when you entered supermarkets, how much effort have you put in to identifying appropriate sites for a supermarket.

25 MR E KOUNDOURIS: Every day. Constantly. We have just about every agent in Sydney in particular that we make contact with, and two members of our staff are almost full-time, including myself. We are all at it.

30 MR O'DONOVAN: Okay. So in that 17 years is it fair to say that the six sites that you've acquired are the only opportunities you've had to acquire sites?

MR E KOUNDOURIS: We have tried, as I said, two other sites where we heard smaller AGAs were for sale. For example, the Charnwood that I mentioned in my statement, and they chose to give to the - sell to Woolworths irrespective of price,
35 because they consider them a better tenant. The owner of the property happened to own, in Charnwood, the business as well.

MR O'DONOVAN: You also mentioned Jindabyne.

40 MR E KOUNDOURIS: Yes, Jindabyne. I personally spoke to the owner of the business, who also happened to own the premises, and he said, "Eric, I know you, I know of your operation, you are quite acceptable to me, but I'd rather have Woolworths as my tenant, a national company, than a smaller supermarket, but if we fail with them, I'll come back to you."

45 MR O'DONOVAN: Right.

MR E KOUNDOURIS: Again we failed and, of course, more recently in December of last year, we entered into negotiations with a small store - grocery store in Karabar. We know this store very well. We have, in order to assist them and to assist ourselves in buying power - we've given them a licence to use our name and
5 buy together with us.

They decided they wanted to sell. We were told by them that they had offered it to Woolworths and Coles, but both of those parties were not interested, and we eventually entered into a contract to purchase. Contracts were issued, ready to
10 exchange, then they changed their minds, and I understand that Woolworths came in and paid more money, and now they are not willing to even talk to us.

MR O'DONOVAN: And the - that was after you'd been told specifically that Woolworths were not interested in the site.
15

MR E KOUNDOURIS: Correct.

MR O'DONOVAN: So to what do you - - -

20 MR E KOUNDOURIS: Correction, we were told by the agent selling the premises that he had offered it to Woolworths and Coles.

MR T KOUNDOURIS: We were also told by the owner of the store.

25 MR O'DONOVAN: Right. Okay. Were you provided with any explanation as to why Woolworths' position changed?

MR E KOUNDOURIS: I don't know.

30 MR T KOUNDOURIS: From the time the solicitors issued the contracts, there was some toing and froing, and then suddenly they went quiet. We haven't heard from them since, and it's come to light that Woolworths have now - have made an offer and virtually gazumped us on that one.

35 MR O'DONOVAN: Right.

MR E KOUNDOURIS: The lawyer - I should add, the lawyer for the vendor, the owner of the business, told our lawyer, when pressed, "What are we doing, we are ready to exchange?", he said, "You were never going to get this."
40

MR O'DONOVAN: Right.

MR E KOUNDOURIS: I don't know why he said that.

45 MR O'DONOVAN: But you have no explanation as to why that was?

MR E KOUNDOURIS: No.

MR O'DONOVAN: Okay. And if there had been - if you had been able to identify more suitable sites in that 17-year period, would you have acquired them if the market opportunity was there?

5 MR E KOUNDOURIS: Oh, yes.

MR O'DONOVAN: Now then, going back to 1991, when you established your first store, can you just describe for us the wholesaling arrangements that were in place at that time. How it was you were able to acquire your - - -

10

MR E KOUNDOURIS: There was a warehouse called GNL warehouse in Fishwick. That was primarily owned by a number of smaller independents, trading, most of them at the time, as Shop Rite. We were able to join in with them. We were supplied by GNL warehouse. We were able to do our own rebates and direct

15

MR O'DONOVAN: Yes.

MR E KOUNDOURIS: And the large formats of the store - there were four of us at the time, and three of those subsequently were sold to Woolworths and Coles - combined together to provide a different banner to the Shop Rite banner, one which was in direct competition with Woolworths and Coles.

20

MR O'DONOVAN: And they were all called Superbarn stores, were they?

25

MR E KOUNDOURIS: Yes.

MR O'DONOVAN: But you at that stage only owned one.

30 MR E KOUNDOURIS: That's right.

MR O'DONOVAN: Now, in terms of the wholesaling arrangement, you had direct dealings with the supplier - the particular supplier like Arnotts and Westerns and the bread manufacturers, or - - -

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MR T KOUNDOURIS: Back then we were able to negotiate what we call the supply rebates directly with companies that sold their stock to us through this - through the warehouse.

40 MR O'DONOVAN: Yes.

MR T KOUNDOURIS: And subsequently the GNL warehouse was sold to the David s family.

45 MR O'DONOVAN: Now, just before we move on to that, just so I'm clear - so you would get a percentage discount on the goods that suppliers supplied to you. You would get a monthly payment back.

MR E KOUNDOURIS: A loyalty rebate.

MR O'DONOVAN: That allowed you to sell - - -

5 MR T KOUNDOURIS: Yeah, a loyalty rebate, yes.

MR O'DONOVAN: Okay, and did you just pay your warehouse for warehouse services, as in you paid them money.

10 MR T KOUNDOURIS: That's right, we paid a service fee.

MR O'DONOVAN: And was that the extent of the relationship with the wholesaler?

15 MR T KOUNDOURIS: Yes. The GNL warehouse, originally - because it was formed, it was a non-profit warehouse, it was a cost centre, if you like, where that then - once it was sold, changed.

MR O'DONOVAN: Right. Okay. All right, can you tell us about - so then that
20 wholesaler was then sold, and who was it sold to?

MR T KOUNDOURIS: The Davids family.

MR O'DONOVAN: Okay. And at that stage Davids - how big were Davids in
25 wholesaling?

MR T KOUNDOURIS: They were quite big. They had warehouses around the country. They were probably the biggest wholesaler to independents at that time.

30 MR O'DONOVAN: Okay. And then what was your arrangements with Davids when they owned the warehouse?

MR T KOUNDOURIS: They - they left us alone as Superbarn. They did try and
35 streamline the banner groups, but they left us alone, but one of the big changes was that they were then negotiating these supply rebates directly with the suppliers, and then they'd pass on to us what they called a fixed loyalty rebate, but then we'd still pay a service fee as well.

MR O'DONOVAN: Right. Okay. So in terms of the rebates began being managed
40 by the wholesaler, and you had less direct dealings with the suppliers.

MR T KOUNDOURIS: Yeah. Our dealings then changed from doing what we
45 called supply agreements, to negotiating what we call now street dollars, where they come in and offer deals for displays and things like that.

MR O'DONOVAN: When you say "they", who comes in, and what do they offer money for?

MR T KOUNDOURIS: Sales representatives from the companies will come in and they'll say, "If you put an end of toilet paper here, we'll give you one carton in 10 and you discount the price."

5 MR O'DONOVAN: Right.

MR T KOUNDOURIS: Along those lines.

10 MR O'DONOVAN: So someone from direct from Kimberly-Clark - - -

MR T KOUNDOURIS: Clark.

MR O'DONOVAN: - - - will come into the shop - - -

15 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: - - - and offer you a particular deal if you'll promote their product - - -

20 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: - - - in a particular way?

25 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: Okay. And at that stage did you have an alternative? If you had been unhappy with Davids, was there an alternative wholesaler you could use?

30 MR E KOUNDOURIS: For a short period.

MR T KOUNDOURIS: For a short period of time there was Composite, but soon after they bought GNL, Davids actually bought Composite as well. Once that happened, there was really no alternative until the Cannons Group was formed.

35 MR O'DONOVAN: Okay.

MR T KOUNDOURIS: And then there was a AIW warehouse we could have gone to.

40 MR E KOUNDOURIS: But that warehouse was subsequently bought out by Woolworths, and closed down.

45 MR O'DONOVAN: Right. Okay. And did you ever use that alternative wholesaler, or did you stay with Davids?

MR T KOUNDOURIS: No, we stayed with Davids.

MR O'DONOVAN: And then did Davids change ownership.

MR T KOUNDOURIS: Yes, Davids were later bought out by Metcash.

5 MR O'DONOVAN: And at the time that Metcash bought Davids, was - what was - what, were all of your wholesale arrangements for dry groceries going through Davids?

MR T KOUNDOURIS: Yes.

10

MR O'DONOVAN: Okay. And then did anything change when Metcash took over?

MR T KOUNDOURIS: No, that relationship continued. The exact terms of the
15 relationship did alter slightly.

MR O'DONOVAN: Sure. Okay. And in terms of warehousing alternatives, do you have an alternative wholesaler to Metcash at the time?

20 MR T KOUNDOURIS: No.

MR O'DONOVAN: No. Is there an alternative to Metcash anywhere in Australia?

MR E KOUNDOURIS: Franklins.

25

MR T KOUNDOURIS: Potentially Franklins, but Franklins want you to banner your store Franklins, and sign one of their supply agreements which - - -

MR E KOUNDOURIS: Franchise agreements.

30

MR T KOUNDOURIS: Or franchise agreements is probably a better word, and we are not willing to do that.

MR O'DONOVAN: Sure. So if you want to stay operating as Superbarn - - -

35

MR T KOUNDOURIS: Yes.

MR O'DONOVAN: - - - you have no choice other than to use Metcash as your wholesaler.

40

MR T KOUNDOURIS: Absolutely.

MR O'DONOVAN: All right. Could you deal directly with suppliers yourself? Do you have the scale to make that possible?

45

MR T KOUNDOURIS: No, not at the moment.

MR O'DONOVAN: What sort of scale would you need in order to do what Franklins did, which was to stop using Metcash and effectively wholesale themselves?

5 MR T KOUNDOURIS: We'd have to triple - to quadruple our size before we could even consider it.

MR O'DONOVAN: Sure.

10 MR T KOUNDOURIS: So that's a long way away.

MR O'DONOVAN: Okay. So in terms of your grocery supplies - that's dry good supplies - - -

15 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: - - - what are your arrangements now?

MR T KOUNDOURIS: That would be confidential. I wouldn't want to speak
20 openly about those.

MR O'DONOVAN: Sure, but are street dollars still available from - - -

MR T KOUNDOURIS: Yes.

25 MR O'DONOVAN: So you still get these opportunities to promote products.

MR T KOUNDOURIS: That's right. Street dollars will always be available because
30 it's difficult for Metcash to sell space within a store, because you've got all these different owners, so the reason we get street dollars is that's the way companies buy display ends and things like that.

MR O'DONOVAN: So at the end of an aisle - I think it's called a gondola end?

35 MR T KOUNDOURIS: That's right.

MR O'DONOVAN: You can effectively sell that space in your - in your shops direct to a supplier.

40 MR T KOUNDOURIS: We don't actually receive money direct for that space, but we can receive discounts on the goods that we put in that space.

MR O'DONOVAN: All right. So you get all of your dry goods through your, I
45 guess, people - packaged groceries through Metcash.

MR T KOUNDOURIS: Yes.

MR E KOUNDOURIS: The majority.

MR O'DONOVAN: How do you source your fresh fruit and vegetables?

5 MR T KOUNDOURIS: Okay. We have a buyer in the Flemington markets.

MR O'DONOVAN: Okay, and he's an agent for you, or is he an employee?

10 MR T KOUNDOURIS: He's an employee.

MR E KOUNDOURIS: Works with us.

MR O'DONOVAN: And who does he deal with in those markets? Are they
15 wholesalers that he deals with?

MR T KOUNDOURIS: Yes, basically all the different agents.

MR O'DONOVAN: So he just literally goes to the market each day and buys what?

20 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: Yes. All right. What's the arrangement in relation to deli?

25 MR T KOUNDOURIS: In deli we are able to deal direct with suppliers, so we are
dealing with Primo and those type of companies directly.

MR O'DONOVAN: Right. Okay. And the - and meat - what arrangements do you
have for sourcing meat and chicken - - -

30 MR T KOUNDOURIS: Exactly the same. We deal with companies directly.

MR O'DONOVAN: Direct. Okay. So it is not necessary to deal through a
wholesaler for those?

35 MR T KOUNDOURIS: No.

MR O'DONOVAN: Liquor?

40 MR T KOUNDOURIS: Liquor we buy through AIW. You need a wholesaler to do
that.

MR O'DONOVAN: So there's a specialist liquor wholesaler?

45 MR T KOUNDOURIS: AIW is owned by Metcash.

MR O'DONOVAN: Okay.

MR T KOUNDOURIS: ALM, sorry.

MR O'DONOVAN: Okay. Is that a different subsidiary to the subsidiary you deal with on your groceries?

5

MR T KOUNDOURIS: Yes.

MR E KOUNDOURIS: It's a wholly-owned subsidiary of Metcash.

10 MR T KOUNDOURIS: Of Metcash, yes.

MR O'DONOVAN: Okay. All right. Now, in relation to your competitiveness on retailing, and if this is a question you don't want to answer publicly, please let me know, but does it affect your ability to compete on price dealing through a wholesaler.

15

MR T KOUNDOURIS: I think we'll leave that one confidential, yeah.

MR O'DONOVAN: Sure. And in terms of fresh fruit and veg, does the fact that you can have a relationship directly with suppliers, does that make it easier to be competitive?

20

MR T KOUNDOURIS: Yes, it does.

MR O'DONOVAN: It does. All right. Now, in terms of the operation of the wholesale market, do you have any - are you able to observe whether Coles and Woolies are participating? In the fruit and veg side of the market, do you observe Coles and Woolworths operating in that part of the market, in the wholesale end of the market, or are their arrangements primarily direct?

30

MR T KOUNDOURIS: Their arrangements - we don't get to see what they are paying for goods or - you know, how - you know, they buy some through the markets, some direct from growers, but we really don't see that side of the business.

MR O'DONOVAN: Right. Can you - do you see affects in the wholesale market when they are buying?

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MR E KOUNDOURIS: Yes.

MR T KOUNDOURIS: Absolutely. I mean, if they've got a particular product on special, then there's less around for us to buy, so the price of that product will go up for that week.

40

MR O'DONOVAN: Right. And are you constrained entirely to buying through that market, through the wholesale market?

45

MR T KOUNDOURIS: Yes.

MR O'DONOVAN: So if tomatoes are on special at Woolworths, are you saying there'd be a shortage of tomatoes in the - - -

MR T KOUNDOURIS: There could be.

5

MR O'DONOVAN: - - - in the wholesale market.

MR T KOUNDOURIS: There could be.

10 MR O'DONOVAN: Right. Okay. And presumably you have to stock some of those products, like tomatoes.

MR T KOUNDOURIS: You have to, you've got no choice. Absolutely.

15 MR O'DONOVAN: So then you become a price taker in the market.

MR T KOUNDOURIS: Yes.

20 MR O'DONOVAN: Right. And is there anything - I mean, are you able to adopt strategies that, I suppose, reduce that effect on you, so that you are less subject to those big fluctuations in wholesale price that might be caused by the strategies of major supermarkets?

25 MR T KOUNDOURIS: It all comes down to volume, and the problem we have is, you know, the more volume you have, then the more the agents or different suppliers take care of you. It's almost that simple. So if you've got the volume, you become an important customer to them, and then they don't let - you know, no matter what happens, they make sure that they service you because they want your business all year round, so the more we can grow, the more we can overcome those issues.

30

MR O'DONOVAN: Sure. And at the moment is four stores enough to give you sorts of volume - - -

MR T KOUNDOURIS: No, no, it is not.

35

MR O'DONOVAN: Now, presumably you have to do some sort of price monitoring on Coles and Woolworths to - - -

MR T KOUNDOURIS: We do.

40

MR O'DONOVAN: - - - get an assessment of how you are sitting in the market competitively.

MR T KOUNDOURIS: Yes, we do.

45

MR O'DONOVAN: All right. Now, do you notice - well, firstly, do you notice differences in the way they price their stores that are close to you or another independent?

5 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: What's the effect of having an independent nearby?

10 MR T KOUNDOURIS: I'll give you an example where when we took over the Wanniassa store, we expanded it, and about two weeks before we relaunched the store - Woolworths have stores all around Wanniassa - they have got Erindale, Kambah and Mawson. In the Erindale and Kambah store, they ran a campaign for eight weeks - two weeks before we relaunched - where they did some deep cut-below cost specials just in those two stores; so, yeah, it certainly makes them sharpen their
15 pencil and get competitive to try and prevent the loss of any business.

MR E KOUNDOURIS: Not only that, but in that particular example, they, in our view, were predatory, in that they put on their fliers, "Available only to customers at Erindale and Kambah", which is immediately next to Wanniassa. Why not the rest
20 of the Canberra?

MR O'DONOVAN: Right. So it wasn't a special that was available generally.

25 MR E KOUNDOURIS: No.

MR T KOUNDOURIS: No, only in those two stores.

MR E KOUNDOURIS: And, coincidentally, the week we opened.

30 MR O'DONOVAN: Right. And how long was this kind of - and what made - did you know enough about the pricing the products to know it was particularly sharp, the pricing?

35 MR E KOUNDOURIS: Yes.

MR T KOUNDOURIS: Oh, absolutely.

40 MR O'DONOVAN: In your assessment, do you think it would have been below cost?

MR E KOUNDOURIS: Yes.

MR T KOUNDOURIS: Yes.

45 MR O'DONOVAN: And how long did this kind of promotion selling last?

MR E KOUNDOURIS: We complained to the ACCC and the ACCC - I don't know what happened between them and Woolworths, but eventually - it took time, but it did stop.

5 MR O'DONOVAN: Okay. Now in relation to those stores that are close to the Wanniasa store, have you noticed any general pricing trends that are different to Woolworths stores that are more distant from an independent supermarket.

MR E KOUNDOURIS: Yes, yes.

10

MR O'DONOVAN: And what's - what have you noticed?

MR E KOUNDOURIS: We did one survey where before we opened at Wanniasa, before Woolworths Mawson and Woolworths Dixon - Woolworths Dixon being the nearest to us in the city - and those two stores had a price variance, Mawson was much more expensive.

15

MR O'DONOVAN: Right. And what did you put that down to?

20 MR E KOUNDOURIS: Because here they had competition, and in Mawson there was Mawson, Erindale, Kambah - all Woolworths.

MR O'DONOVAN: All right. Now, I suppose that might be an effect from an independent. Do you notice their pricing is different when Coles and Woolworths are located close to each other?

25

MR T KOUNDOURIS: We find that they tend to price match each other.

MR O'DONOVAN: Right.

30

MR T KOUNDOURIS: In our price surveys.

MR O'DONOVAN: Right. So does that mean they are more competitive when they are close to each other?

35

MR T KOUNDOURIS: No, they are just matching prices and not competing.

MR O'DONOVAN: Right. Okay. Now, in terms of that dynamic, how Coles and Woolies price, have you observed how they react to each other when it's just the two players in the marketplace?

40

MR T KOUNDOURIS: All we can refer to is our price surveys. Like I said, they tend not to - or appear not to be having a go at each other. They just keep the prices the same.

45

MR O'DONOVAN: Right. But they are more aggressive when you are present.

MR E KOUNDOURIS: Certainly.

MR T KOUNDOURIS: Yes.

5 MR E KOUNDOURIS: We should add that they become aggressive or change their prices when a full-blown supermarket goes near them. They don't seem to care too much about the convenience store or the smaller AGA.

10 MR O'DONOVAN: Right. So - and when you say a smaller IGA, of the kind that typically are around Canberra.

MR E KOUNDOURIS: Yes.

15 MR T KOUNDOURIS: In your local shopping centre, yes.

MR O'DONOVAN: Right. So do those kinds of stores drive competition on price?

MR E KOUNDOURIS: No.

20 MR T KOUNDOURIS: No, they can't afford to.

MR O'DONOVAN: Right. Okay. All right. Now, in terms of the, I suppose, just the price of retail goods generally in your stores over the last five years, have you - firstly, have you noticed any affect - big affects in the market by things like the drought?

25 MR T KOUNDOURIS: Yes, certainly there were times, particularly when you look at meat prices and produce prices, where, you know, they've fluctuated because of shortage of supply.

30 MR O'DONOVAN: Right. And that's what you observed in the wholesale markets?

MR T KOUNDOURIS: Yes.

35 MR O'DONOVAN: Right. So is it fair to say that some of the changes in retail pricing is a result of changes at the wholesale level - shortages of supply at the wholesale level?

40 MR T KOUNDOURIS: Certainly in fresh foods, yes.

MR O'DONOVAN: Okay. And in terms of how the Flemington markets - I think it was Flemington - - -

45 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: - - - you said you buy from.

MR T KOUNDOURIS: Yes.

MR O'DONOVAN: In terms of how they operate, is it - is it more or less just
5 straight supply and demand; you know, that when there's a lot of something around,
you'll get it at a good price?

MR T KOUNDOURIS: Yeah, absolutely.

MR O'DONOVAN: Now, does retail - is - are those features of the wholesale mark
10 reflected very strongly in the retail market?

MR T KOUNDOURIS: Yes.

MR O'DONOVAN: So generally retail pricing will respond - - -
15

MR T KOUNDOURIS: Absolutely.

MR O'DONOVAN: Right. And who would - - -

20 MR T KOUNDOURIS: In terms of the way we operate.

MR O'DONOVAN: Okay. And are there other sellers of fruit and veg or fresh
product in Canberra that react in the same way to the wholesale - - -

25 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: - - - that are sensitive to the wholesale market?

MR T KOUNDOURIS: Some of the big fruit shops who are buying out of
30 Flemington markets would operate the same way.

MR O'DONOVAN: Right. And is the reaction of the major supermarkets different
to fluctuations in the wholesale price.

35 MR T KOUNDOURIS: It's difficult to comment because I know that - I've heard
stories about how they have - they contract prices for a period so they set their prices
for longer, so if the market goes up or down, they may not receive the benefit, or pay
the extra, but I really don't know for certain about that.

40 MR O'DONOVAN: Right.

MR E KOUNDOURIS: But the volume is so great that it's logical that they set the
prices at the markets.

45 MR O'DONOVAN: They set the price to the supplier, or at the retail level?

MR E KOUNDOURIS: To the supplier.

MR O'DONOVAN: Okay. But at the retail level, from your observations, can you see when there's a seasonal glut of a particular - I mean, just a lot around - - -

MR T KOUNDOURIS: Yes.

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MR O'DONOVAN: - - - do the major supermarkets tend to put products like that on special, or - - -

MR T KOUNDOURIS: Yes.

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MR O'DONOVAN: - - - do their prices exhibit those seasonal fluctuations you'd expect?

MR T KOUNDOURIS: You'd certainly see the ups, not necessarily the downs, because if they've got a contract price, and - they may not.

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MR O'DONOVAN: All right. Now, and in terms of your pricing, is there a - do you notice any consumer preference for, I suppose, more less volatile prices, or - and do you try and price accordingly, or do you more try and match what's happening at the wholesale level in terms of retail pricing?

20

MR T KOUNDOURIS: We match what's happening at the wholesale level, but we also know there's some lines that are sensitive to price, so if you can drop the price on it, you might sell a lot more of it, so we try and do that, try and increase our volume that way.

25

MR E KOUNDOURIS: We do know that if our ability to purchase more increased - and we tested this theory, where we've gone direct to a farmer and bought a semitrailer last Christmas, for example of rockmelons, and we were able to sell those and still maintain our margin at least \$2 below Woolworths, so if we had more volume, then we'd be certainly be more competitive.

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MR O'DONOVAN: Right. As in you could do more of these direct deals - - -

MR E KOUNDOURIS: Absolutely.

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MR O'DONOVAN: - - - with the grower. And in a deal like that, when is price set? Is it basically the day it's dispatched from the farm or - - -

MR E KOUNDOURIS: By that day when we talk to the farmer.

40

MR O'DONOVAN: And for the farmer the benefit is he doesn't have to go through a wholesale market, is that - - -

MR E KOUNDOURIS: Well, he might have excess stock. I don't know why, in this instance. We just rang the farmer up and said, "We want to buy a semitrailer of

45

rockmelons, how much?", and we knew the market price, so it was cheaper, we bought it.

MR O'DONOVAN: Yes.

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MR E KOUNDOURIS: But it was conditional that we bought a whole semitrailer.

MR O'DONOVAN: Right. Okay. Now, in terms of warehousing capacity, you don't - do you have any warehousing capacity?

10

MR E KOUNDOURIS: No.

MR T KOUNDOURIS: No.

15 MR O'DONOVAN: Okay. So how do you deal with the distribution of the semitrailer load of rockmelons? How is that done?

MR T KOUNDOURIS: We generally bring it in to one store, break it down, and then use some subcontractors to deliver the stock to the other stores.

20

MR O'DONOVAN: Right. And that's including the stores in Sydney?

MR T KOUNDOURIS: Yes.

25 MR O'DONOVAN: Right. Okay. All right. Now, in - now, I just want to talk to you about how - how sites are obtained. Now, if we can just start with the ACT.

MR T KOUNDOURIS: Yes.

30 MR O'DONOVAN: And let's say a new area is opening up in Gungahlin - perhaps using that as an example. Obviously there's a need, with a new area, to establish some kind of shopping facilities.

MR T KOUNDOURIS: Yes.

35

MR O'DONOVAN: How is land released through shopping?

MR E KOUNDOURIS: Usually through the auction system.

40 MR O'DONOVAN: As in the land is identified and zoned by the ACT Government?

MR E KOUNDOURIS: Under the land planning system of the ACT, a group centre, a new group centre - there's a site identified to be the shopping centre for
45 that - a number of suburbs around it. That goes to auction.

In our past experience, either Woolworths or Coles buy these things. In the last one we attended was in the Conder - suburb of Conder. The Woolworths representative had his arm up in the air through the entire auction time. All he kept saying, "Is that my bid?" Eventually he got it, and paid a premium, but so what? They are
5 surrounded with Woolworths supermarkets and markets that they need to protect.

MR O'DONOVAN: Okay. So in relation to a site like that, is it already known what the tenant mix is likely to be in that centre?

10 MR T KOUNDOURIS: Yes.

MR E KOUNDOURIS: 90 per cent of it, yes.

MR T KOUNDOURIS: Yes.

15

MR O'DONOVAN: And you'll know it's just one supermarket?

MR E KOUNDOURIS: Yes.

20 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: Is that because of the size of the site, or because of its location that you know it's only going to be one - - -

25 MR E KOUNDOURIS: I think because of the amount of population around it.

MR O'DONOVAN: So, is there actually a planning control on their being just one supermarket, or is that - - -

30 MR E KOUNDOURIS: Usually it's released as a - one large supermarket, and number of specialties.

MR O'DONOVAN: Right.

35 MR E KOUNDOURIS: Essentially, yes.

MR O'DONOVAN: So that's already determined by - is that determined by the developer - - -

40 MR E KOUNDOURIS: The planner.

MR O'DONOVAN: - - - or is that determined by the ACT?

MR E KOUNDOURIS: The planner.

45

MR O'DONOVAN: So the planners have decided - - -

MR E KOUNDOURIS: Yes.

MR O'DONOVAN: - - - effectively, to grant a local monopoly.

5 MR E KOUNDOURIS: It is a viable system, and it works well.

MR O'DONOVAN: Okay. Now, explain that.

10 MR E KOUNDOURIS: We've got a retail hierarchy in the ACT, and you've got your local centre, which usually houses a small independent supermarket of 300-400 square metres, perhaps a newsagent and a chemist, maybe a doctor or something, that serves just that suburb. The next move from there is the group centre, which might service four or five of these suburbs - the smaller suburbs; and, of course, there are other group centres nearby.

15

In Canberra, it's easy. Traffic is not an issue. It's easy to move from one to the other. If you are not happy at the supermarket at a particular group centre, it is not far to the next one. Except in Canberra, of course, most of them all house Woolworths or Coles, to the extent where Woolworths is about 65 per cent-odd, Coles is about 20 27 per cent - in the full-blown supermarkets I'm talking about, and we've got 8 per cent.

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MR O'DONOVAN: Right. Okay. So at the time at which it goes to auction, it's known that it will be a single supermarket development.

MR E KOUNDOURIS: Yes.

30

MR O'DONOVAN: All right. And is it Coles and Woolworths that buy it? When they are bidding, they are bidding to acquire the whole site.

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MR E KOUNDOURIS: Usually Woolworths and Coles would bid in their own right. As well, there would be developers that bid; and, of course, they have a preference for having Woolworths or Coles as a tenant. If they are successful, they know they are going to get one of them. That's how - or Woolworths might go along to the auction, or Coles, with a developer in tail - they've done an agreement beforehand, if the developer buys it, Woolworths will get the store.

40

MR O'DONOVAN: Okay. So sometimes Coles and Woolworths don't buy the freehold, but they already have been identified as the - been identified as the end tenant - - -

MR E KOUNDOURIS: It's been a mixture of both.

45

MR O'DONOVAN: - - - to develop it. Okay. Have you tried to create relationships with developers to - - -

MR E KOUNDOURIS: Well, we don't need to. We have our own development arm, and we have tried. Usually developers in Sydney will ring Woolworths first, Coles second, then if they don't want it, which means it is not a good site anyway, they might call us.

5

MR O'DONOVAN: Right, okay. So in Canberra, in the last 17 years, have you attended many of these auctions for these sites.

MR E KOUNDOURIS: I don't know about "many", but we've attended, but knowing that we had no chance anyway. They will pay a substantial premium in order to protect their market. It's as simple as that.

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MR O'DONOVAN: And by that you mean because there are Woolworths stores, the next nearest stores are Woolworths stores - - -

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MR E KOUNDOURIS: Yes.

MR O'DONOVAN: - - - they have an interest - - -

MR E KOUNDOURIS: Not to mention Canberra overall. Canberra has more Woolworths stores than any other State in Australia, on a - - -

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MR O'DONOVAN: Per capita.

MR E KOUNDOURIS: Per capita.

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MR O'DONOVAN: All right. And so that's - that's how sites - and sites are always allocated this way, by an auctioning process.

MR E KOUNDOURIS: Sometimes they are by expressions of interest, but it's a similar thing.

30

MR O'DONOVAN: Right. The same competitive process.

MR E KOUNDOURIS: There has been a situation when Aldi entered the market in Canberra, where the Government, in order to enable competition to occur, direct sold to them, I think, two or three sites - two sites.

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MR O'DONOVAN: Okay. And do you know how they were able negotiate that?

40

MR E KOUNDOURIS: I think it's an open system. The Government valuers value the site, Aldi pays the valuation, there's no right of appeal to the price, and do their store.

MR O'DONOVAN: Have you tried to acquire sites that way?

45

MR E KOUNDOURIS: I'd like to treat that as confidential.

MR O'DONOVAN: Okay, sure. All right. Now, in the break-up of - as I am sure you are aware, Franklins - the Franklins Group was broken up in around about 2001.

MR E KOUNDOURIS: Yes.

5

MR O'DONOVAN: And quite a number of its supermarkets were sold to Woolworths, and another group was sold to Pick 'n Pay from South Africa. Did you attempt to participate in that process?

10 MR E KOUNDOURIS: Yes, very much so. We were initially led to believe, by Davids and Metcash, whoever - I think it was Metcash.

MR T KOUNDOURIS: Metcash.

15 MR E KOUNDOURIS: Who came to us and said, "You are the only ones in our banner group capable of running full-blown stores, and we will assure you that you'll get some of those". They also said that they had information that the ACCC would intervene and Woolworths would not get any stores at all.

20 Subsequent to that, we discovered that this was not necessarily so, and we made an offer. I visited the head office of Franklins and verbally, and then subsequently in writing, made an offer to purchase 35 stores, of which we got none.

25 We tried to also place ads in the local press of Sydney setting out what the - what we believed to be the situation with the Sydney metropolitan area - that Woolworths, in our belief, were really not buying stores as such, they were buying sites.

30 In our belief, and it was proven because they weren't trading profitably - Franklins had no goodwill to sell, so it was actually buying sites, and in the final split-up, Woolworths got 19, off memory, independents got the rest, and the headline read that way, but in reality, the stores that Woolworths got were more in sales volume than what the independents got, but more important than that, the stores that the independents got, and subsequently via Metcash, became AGAs we would not have wanted. Woolworths didn't want them because they could never be made into a
35 full-blown supermarket. So the cream, or the full-blown supermarket, virtually 100 per cent, went to Woolworths.

MR T KOUNDOURIS: And was subsequently converted into Woolworths.

40 MR E KOUNDOURIS: Under that banner, yes.

MR O'DONOVAN: All right. Okay. Now, in terms of the sites that you have obtained in Sydney and been able to develop, has the - has that - has the planning process facilitated your entry into the market?

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MR E KOUNDOURIS: We certainly haven't got any special treatment. In fact, on average, we - from the day we acquired the site, because we'll get Woolworths and

Coles - will certainly object because they are nearby somewhere, and that process takes a long time, usually three, three and a half years, which means your capital to acquire the site, without return, is sitting there for that period of time.

5 And our next problem is the land in Sydney is so expensive even once you acquire it, that you need to find another use, otherwise it won't stack up. It will be the most expensive supermarket in the world. So all that process is very, very slow, and very, very expensive.

10 MR O'DONOVAN: Now, just in terms of the planning process. You say that Woolies or Coles object?

MR E KOUNDOURIS: Yes.

15 MR O'DONOVAN: And that's when you are attempting to get land that isn't currently being used as a supermarket to be rezoned, or just to get the development approved even if the zoning permits a supermarket.

20 MR T KOUNDOURIS: We've only had one instance - well, we've had many opportunities - one instance where they've objected. I think Coles objected to the DA. This is the Sans Souci. That DA also involved the re-zoning of the land.

MR O'DONOVAN: Right. Okay. It was at the time zoned residential or - - -

25 MR E KOUNDOURIS: And some special.

MR O'DONOVAN: Right. Okay.

30 MR E KOUNDOURIS: The council, Rockdale council, identified through their own process that a supermarket was needed in the area for competition. The two supermarkets nearby are both Coles, and virtually encouraged the then owners of the site to seek the rezoning. Woolworths made an offer in writing to be the tenant, and that's when we came into the picture and, acting out of square, if you like, ended up making the owners partners in the development.

35 MR O'DONOVAN: Right. Okay. And in terms of the objection that Coles had to the development, were you provided with a copy of the Coles objection, or advised of its contents?

40 MR E KOUNDOURIS: The council makes them available to us, yes.

MR O'DONOVAN: And what did you understand was the nature or reason for Coles objecting to - - -

45 MR E KOUNDOURIS: I can't recall. I do have a copy. Happy to give it to you.

MR O'DONOVAN: Sure. Okay. And did that have the effect of delaying the opening of the supermarket - Coles' objection?

5 MR E KOUNDOURIS: Absolutely. There were other objections from residents and other people, of course, yes.

MR O'DONOVAN: Right. Okay.

10 MR E KOUNDOURIS: The only instance we have, which, I mean, it doesn't relate to this inquiry, but with liquor, we also - in all our stores in Canberra - it's a different legislation - have, as one of our departments, a liquor department, which makes it very convenient for somebody to do all their shopping in the one place.

15 We tried to get a liquor licence at our Five Dock store, across the road from us with a small BWS store. Woolworths threw all its resources and objected to it very strongly. We ended up in court, we lost, and now we reapplied under new legislation. Woolworths again has objected, and it's 12 months since we've lodged that application and we haven't heard.

20 I should add that the cost of this process in both cases is close to half a million dollars just to get a liquor store.

MR O'DONOVAN: Okay. Now which liquor licence was that?

25 MR E KOUNDOURIS: At the Five Dock's site.

MR O'DONOVAN: Five Dock's site. So it still currently doesn't have a liquor licence?

30 MR E KOUNDOURIS: Correct.

MR T KOUNDOURIS: That's right.

35 MR O'DONOVAN: And you've been attempting to get one - - -

MR E KOUNDOURIS? Yes.

MR T KOUNDOURIS: Five years.

40 MR O'DONOVAN: Five years. Okay. And in terms of your grocery business, would that be an asset to the supermarket to have - - -

MR E KOUNDOURIS: Absolutely.

45 MR T KOUNDOURIS: Yes.

MR O'DONOVAN: Right.

MR T KOUNDOURIS: It's another draw card.

MR O'DONOVAN: Right. Okay.

5 MR E KOUNDOURIS: I should add that in the - because we were the developer, if
you recall at the Five Dock site, when we set up a section specifically to meet the
requirements of the New South Wales legislation for a liquor store, when
Woolworths found out, they actually offered to be our tenant within our store. Of
course, it was refused.

10 MR O'DONOVAN: Yes. Okay. Now, the next questions I have are really about
the specific supply terms which I think will all be confidential.

15 CHAIRMAN SAMUEL: Okay, before we move into that, have you got anything
else you want to do that are public?

MR O'DONOVAN: No, I think that's - I'll - no, I think that is all that I can ask.

20 CHAIRMAN SAMUEL: I'll just check with the commissioners, if they've got
anything on the material we've had today.

COMMISSIONER KING: Not at the moment. I think we've covered - - -

25 COMMISSIONER MARTIN: The only issue was with that 35 Franklin stores you
bid for. Was it that you - your price was too low, or - - -

MR E KOUNDOURIS: No, no, absolutely not.

30 COMMISSIONER MARTIN: So what was the reason?

MR E KOUNDOURIS: No reason was given to us.

35 CHAIRMAN SAMUEL: I had a similar question. You said in your opening
statement about having been gazumped on - I think your words were, "Gazumped by
Woolworths on a number of purchases." Can I just understand what the word
"gazumping" means for that purpose. Were you gazumped in terms of not knowing
about the sales, or gazumped in the sense that they beat you on price.

40 MR E KOUNDOURIS: Purely on price and a preference to have Woolworths as the
tenant, where in the one instance in Charnwood, the owner of the building was also
the owner of the business.

45 CHAIRMAN SAMUEL: Right. Had there been any instances where you've not
known about the prospective sale, or the that the vendor has not been - not felt at
liberty to approach you to - to talk about the possible sale of his or her business?

MR E KOUNDOURIS: Not that I'm aware of.

MR T KOUNDOURIS: I'll just expand on that though. More recently, with the incident that happened at Karabar, Woolworths initially were not interested in the site until we were interested, and we believe that once we'd gotten to the contract stage, that our offer was then taken to Woolworths, and because we'd go there and would provide competition to their stores, they suddenly did become interested and were willing to pay above market to keep us out of the market.

MR E KOUNDOURIS: We should also add to that transaction that this particular site at Karabar sits within 1 kilometres of the existing Woolworths, which is doing in excess, we understand, turnover, 1.6 million a week in the town centre of Queanbeyan, and it sits in the middle between that store and the Jerrambomberra store, which is about 2 kilometres on the other side.

CHAIRMAN SAMUEL: Perhaps an area that will - that will come into the supply area, but it will be public in any way, public knowledge - do you sell any Home Brand product?

MR T KOUNDOURIS: Yes, we sell the Black & Gold brand.

CHAIRMAN SAMUEL: You sell the Black & Gold - so that's the Metcash - - -

MR T KOUNDOURIS: Yes.

CHAIRMAN SAMUEL: - - - IGA, Black & Gold.

MR T KOUNDOURIS: Yes.

CHAIRMAN SAMUEL: Anything else that's home product that you acquire yourselves, direct or not?

MR T KOUNDOURIS: No.

MR E KOUNDOURIS: We do a bit of bread at Superbarn. We do have a Superbarn brand, yes.

MR T KOUNDOURIS: We do some of our own branded product.

CHAIRMAN SAMUEL: You do?

MR T KOUNDOURIS: Yes.

CHAIRMAN SAMUEL: And that's - that you acquire direct from suppliers?

MR T KOUNDOURIS: Yes.

CHAIRMAN SAMUEL: What product is that?

MR T KOUNDOURIS: We do our own branded milk, our own brand of bread and we do a nut range also.

5 CHAIRMAN SAMUEL: Right. And the quality of that product compared to - I can do a taste test, I guess, so I think it's probably public, but the quality of the product compared to, say, the equivalent product in Black & Gold, or to take the other - or the real competitor, which would be Home Brand for Coles or Woolworths - how does it compare?

10 MR T KOUNDOURIS: Yes, very well. In most instances it's the same product that companies supply that is branded their own name.

CHAIRMAN SAMUEL: Okay.

15 COMMISSIONER KING: Just, if we could step back to some of the stores that you mentioned earlier on, which - where you have been gazumped by Woolworths. Are you aware of any situations where either Woolworths or Coles have purchased a store that you are interested in, and they have not continued operating it as a grocery outlet?

20

MR T KOUNDOURIS: No.

25 COMMISSIONER KING: So even where they've purchased one which is, in your opinion, fairly close to another store that they own, they've continued to operate both of them.

MR T KOUNDOURIS: Yes, yes.

30 MR E KOUNDOURIS: As far as yes know, yes.

COMMISSIONER KING: That's all I have.

35 CHAIRMAN SAMUEL: All right. Okay. We'll move into the confidential section now, because we are going to be dealing with some commercially sensitive material, so if I can ask for the room to be cleared by all other than ACCC personnel, or those associated with the Koundouris Group.

40 **ADJOURNED**

[2.07pm]

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CONTINUED FROM TRANSCRIPT-IN-CONFIDENCE

RESUMED

[3.00pm]

5

CHAIRMAN SAMUEL: Okay, we are going to start, ladies and gentlemen, thank you. And the witnesses from Pace Farms, could you perhaps just state for the record your name and role in the corporation.

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MR PACE: Paul Pace, Pace Farm, General Manager.

MR GOREY: I'm a lawyer, Steven Gorey, from Henry Davis York. I'm representing Pace Farms.

15

CHAIRMAN SAMUEL: Thank you. Over to you, Mr O'Donovan.

MR O'DONOVAN: Okay. Now, you've been summonsed to appear here today.

20

MR PACE: Yes.

MR O'DONOVAN: That's right. All right, and you understand that you are required to give honest answers to the questions that we ask.

25

MR PACE: Yes.

MR O'DONOVAN: Very good. Can you just state your name - yeah, your name and your position within the company you work for.

30

MR PACE: Paul Pace, General Manager, Pace Farm.

MR O'DONOVAN: Okay. Now, as general manager of Pace Farms, what's involved in that job?

35

MR PACE: Basically I oversee the running of the business, so everything from our farming division, transport division, operations, egg packing floors, and sales and marketing.

40

MR O'DONOVAN: Okay. And in terms of Pace Farms, what - in broad terms, what do they do?

45

MR PACE: Pace Farm is a family run and owned business. We are a vertically integrated company, so we buy our chickens one day old, we rear our chickens up to the point of lay, we then produce eggs, package eggs and market and distribute eggs to a number of outlets.

MR O'DONOVAN: Sure.

MR PACE: So we are vertically in agreement. We also have our own feed mill, and mill our own feed et cetera - not all of our own feed, but we mill a percentage of it.

5 MR O'DONOVAN: Right. Okay. And you are exclusively an egg producer, producing company.

MR PACE: Egg production, yes.

10 MR O'DONOVAN: And in terms of your major customers, can you tell us who they are?

MR PACE: Yes. Major customers - Woolworths, Coles, Franklins - we also have our egg product side, so we supply people like Goodman Fielder, Sara Lee's. These
15 are food manufacturers as well, our processed egg.

MR O'DONOVAN: Now, do you just sell fresh eggs.

MR PACE: No fresh eggs and processed eggs, so we sell liquid pasturised egg,
20 spray dried egg for the food manufacturing sector as well, hard boiled eggs.

MR O'DONOVAN: Okay, and powdered egg, is that a product that you make.

MR PACE: Yes.

25

MR O'DONOVAN: And with your own facilities - - -

MR PACE: Yes.

30 MR O'DONOVAN: - - - you make the powdered egg.

MR PACE: Yes.

MR O'DONOVAN: And do you participate in the export market at all?
35

MR PACE: Very, very minimal. We are export accredited facilities, but, yeah, most production is sold domestically.

MR O'DONOVAN: Okay. Does the - does the - but are there egg products that are
40 traded internationally, that - - -

MR PACE: Yes, but predominantly egg products come into Australia.

MR O'DONOVAN: And they compete with you for - - -
45

MR PACE: Yes, very much so.

MR O'DONOVAN: So that would be in the food service industry.

MR PACE: Food manufacturing sector more than food service, I suppose; so the company's using egg as an ingredient to make another product.

5

MR O'DONOVAN: Right.

MR PACE: For food service, I would consider more the retail sector, other hospitality et cetera.

10

MR O'DONOVAN: Okay. And so - and in terms of the break-up between eggs that end up in a retailer and eggs that end up in the food service sector - - -

MR PACE: Yes.

15

MR O'DONOVAN: - - - can you give us a rough idea of - - -

MR PACE: Look, it does change, and it's seasonal, but it would be, from our latest data, around 50/50. It can vary 45/55, but of the shell egg it's around the 50/50, and then you've got some egg that goes into the manufacturing sector as well.

20

MR O'DONOVAN: Right, okay. So in terms of egg that's consumed as an egg - - -

MR PACE: Yes.

25

MR O'DONOVAN: - - - by end customers - - -

MR PACE: Yes.

30

MR O'DONOVAN: Half of those are consumed through cafes - - -

MR PACE: Yes.

MR O'DONOVAN: - - - and quick-service restaurants, and hospitals.

35

MR PACE: Yes.

MR O'DONOVAN: And then the other half are bought at the retail level.

40

MR PACE: All right.

MR O'DONOVAN: Okay. Now, I'd like to ask you about market share of your retail customers. Would that be confidential?

45

MR PACE: Yes, it would be. It would.

MR O'DONOVAN: It would. Okay, we'll get back to that. All right, now how long have you been in the egg industry?

MR PACE: Me myself?

5

MR O'DONOVAN: Yes.

MR PACE: I have been born into it, so I'm 38 and probably been working in it full-time for near 20 years now.

10

MR O'DONOVAN: Right, okay. So in terms of - if we go back to the 1980s - - -

MR PACE: Yes.

15

MR O'DONOVAN: - - - my understanding is the egg industry was regulated then.

MR PACE: Yes, it was.

20

MR O'DONOVAN: Do you have - can you tell us anything about the way in which it was regulated, and what effect it had on egg production.

MR PACE: On egg production?

25

MR O'DONOVAN: Well, yeah, or egg market generally.

30

MR PACE: Look, when the egg - and, look, I was obviously only a child back then, but, I mean, the regulated industry realistically was a quota system, so you were told how many eggs - how many chickens you could have. You paid a levy on those amount of chickens, and then the market - I suppose production, was - was controlled by the quota cuts et cetera, so if there was a - you know, an oversupply of egg, you would be told that you had to cut your quota, so you would have to produce less.

35

Also back then the Government - because they were different regulators - each State was regulated differently - they had their own marketing boards, and then they had their own export markets for surpluses as well.

MR O'DONOVAN: Right. And then when - then the market was deregulated, I suppose, progressively in each state.

40

MR PACE: Yes.

MR O'DONOVAN: Now, are all your operations located in New South Wales.

45

MR PACE: No.

MR O'DONOVAN: So they are spread across which States?

MR PACE: New South Wales and Victoria and ACT, if you want to class ACT - - -

MR O'DONOVAN: Sure. And what was the effect on the market when it was deregulated - firstly in terms of egg farmers?

5

MR PACE: Look, initially there was - there was the same amount of farmers, but I suppose them coming to grips with how a non-regulated market works - there was obviously quite a lot of competition and people jostling for market share, and also - probably the first time that, I suppose - farmers back then, when you produced eggs, you made money, but they had never seen what a real surplus could do, so by putting more chickens in, didn't necessarily mean more profits. If anything, it's the adverse, and it meant losses.

10

MR O'DONOVAN: Right, and so in the medium term, did that start to even out with the number of farmers or the number of laying chickens reducing?

15

MR PACE: I would say it's still an ongoing process.

MR O'DONOVAN: Right.

20

MR PACE: And will continue to be so in a free market.

MR O'DONOVAN: Yes. Okay. So in terms of the price of eggs in, say, the first five years after it was deregulated, do you have any recollection of what was occurring with the supply price of eggs?

25

MR PACE: Look, when the market gets into an oversupply position, generally that puts pricing pressure downwards.

MR O'DONOVAN: Right, and has - does the market continue to be oversupplied at that farm-gate level, or - - -

30

MR PACE: Well, the market will only be oversupplied for a certain point of time, because an oversupplied market is not a sustainable market, so generally if you are oversupplied for a period, eventually a shortening or a tightening of a market will come after an oversupplied situation, because you can make losses in an oversupplied marketed.

35

MR O'DONOVAN: Sure, and all of that's happened pretty much as you'd expect in the egg industry.

40

MR PACE: Has happened, will happen, and probably will continue to happen going forward.

MR O'DONOVAN: Yes, sure. Okay. Now, if we go back to 1990 again, were all eggs produced out of hens in cages?

45

MR PACE: Gee, let me think back to 19 - I would have to say the vast majority, yes. There was free range getting on the market, I think, in the late '80s, early '90s, but it would be small numbers, but yeah, it would have been a much more conventional farming systems in cage, or we call them conventional farming systems.

MR O'DONOVAN: And then when free range eggs entered the market - - -

MR PACE: Yes.

MR O'DONOVAN: - - - were they sold at a price premium?

MR PACE: Well, the cost of production of those products is significantly higher.

MR O'DONOVAN: Okay, and that's reflected in the price they are sold for at retail.

MR PACE: Yes.

MR O'DONOVAN: Okay. And so what's been the trend in terms of the market shares of free range eggs versus cage laid eggs.

MR PACE: In the retail sector it has been growing.

MR O'DONOVAN: Yes.

MR PACE: But in the food service et cetera, it hasn't been growing. So in the retail sector they are free range, and not only free range, the alternative farming system, so your organic, your free range, your barn, your free range omega - those products are growing, yes.

MR O'DONOVAN: Okay. And is this despite a price differential?

MR PACE: Yes.

MR O'DONOVAN: Okay. So why would a consumer choose the more expensive egg?

MR PACE: You would have to ask a consumer. Really, it's a consumer's choice.

MR O'DONOVAN: But it's an observable phenomenon - - -

MR PACE: Yes.

MR O'DONOVAN: - - - despite higher prices.

MR PACE: Well, I suppose, it's, you know, the welfare of the hen. There's a number of decisions a consumer makes at that point of purchase, so price isn't the

only - isn't the only criteria for all consumers. There'll be a certain consumer that buys on price and price alone, but other consumers may not only have that criteria.

5 MR O'DONOVAN: Sure, and in terms of the proportion of the market now, do you have any sense of the break-up between cage eggs, free range and barn?

MR PACE: In the retail sector?

10 MR O'DONOVAN: Yes.

MR PACE: Free range would be probably 15 to - 15 to 20, within that vicinity.

MR O'DONOVAN: Yes.

15 MR PACE: Probably around 15. Barn would be 5, I suppose, and cage would be the remainder; so cage is still, you know, 70 per cent plus.

20 MR PACE: Okay. And in terms of the relativities of retail price, can you tell us what the relative retail prices are?

MR PACE: Honestly, I don't know all the retail pricing.

MR O'DONOVAN: Sure.

25 MR PACE: We are not involved with retail pricing.

MR O'DONOVAN: Sure. Okay. All right. Now, in terms of the main input costs to an egg - - -

30 MR PACE: Yes.

MR O'DONOVAN: - - - not in terms of amounts, but sort of in rough proportions - - -

35 MR PACE: Yes.

MR O'DONOVAN: - - - of the eggs that you sell, what are the biggest costs in producing an egg?

40 MR PACE: The biggest cost is our grain; grain, and then protein, so Soya, mills, et cetera; so feed is by far the largest cost of producing an egg.

MR O'DONOVAN: Right.

45 MR PACE: We then have, over the last probably seven years, there's been legislative changes as well, different animal welfare standards and codes. Each State is a little bit different, but that has meant more capital expenditure in the

conventional farming systems, and these - you know, building these type of farms is a significant big capital investment. You are not talking small amounts of money.

5 MR O'DONOVAN: Okay. So it - the cost of grain and the cost of soy - - -

MR PACE: Yes.

MR O'DONOVAN: - - - capital costs.

10 MR PACE: Yes.

MR O'DONOVAN: Is fuel a big component - - -

MR PACE: Yes.

15 MR O'DONOVAN: - - - in chicken raising.

MR PACE: Fuel is, and like, obviously, transport, fuel - they are all big costs, but what we are finding now, which is not only - I suppose it's the whole food sector is food costs are now being driven by oil costs because of the biofuels, so we see very much, say, the feed costs following oil cost.

20 MR O'DONOVAN: Okay. And is this a recent development? What sort of time frame would you put on this?

25 MR PACE: Yes. The last couple of years has been horrendous. We've had drought as well, but drought has not been the only contributor to high grain costs. Australia is a net exporter of grains, so the world markets are going to play a significant part in feed costs, not only drought.

30 MR O'DONOVAN: Sure. So in terms of the feed cost, what sort of price movements are we talking about?

MR PACE: From when to when?

35 MR O'DONOVAN: Say the last two years.

MR PACE: 130 per cent.

40 MR O'DONOVAN: So more than doubling.

MR PACE: Yes.

45 MR O'DONOVAN: Okay. And in terms of your ability to pass those costs through to your customers, do you have that ability?

MR PACE: It is not a laid down misere, but we endeavour to pass on costs, yes, but once again, in a commodity-type market, supply/demand, if the industry has got itself into an oversupply situation, it is not always easy to pass on costs because if there's too much supply as per - to the demand, it's very difficult to pass cost increases on.

5

MR O'DONOVAN: Right. And, again, the market - there are periods where the market is oversupplied.

MR PACE: Periods where it's oversupplied and periods where it's undersupplied.

10

MR O'DONOVAN: Right. And is - is there - in terms of the lead time in getting your egg - I suppose choosing how many eggs you are going to make - are we talking you have to plan it two years in advance, or one year in advance? Is it a very flexible market?

15

MR PACE: No, it's an 18-month lead time, but our planning is - we are five years in front with our big picture planning, but 18 months is a cycle, roughly, of a hen, from - you know, they are kept to - to 75 to 85 weeks of age, or 75 probably as an average.

MR O'DONOVAN: Right. So in terms of making predictions about the supply situation at any one time, you are working 18 months in advance.

MR PACE: It's very difficult.

MR O'DONOVAN: Okay. All right. Now then, in terms of how - again, I just want to look at how the egg marketing has changed.

MR PACE: Yes.

MR O'DONOVAN: Say in the early 1990s or after deregulation, were most eggs sold by a brand or using a brand?

MR PACE: Yes, their brands would have been stronger in the early '90s.

MR O'DONOVAN: 100 per cent, or - - -

MR PACE: Look, off the top of my head I don't actually know when the - when the generic were starting to be - like the house brands were put in place, so - - -

MR O'DONOVAN: Sure. All right. But as compared to the early '90s, as opposed to, say, 2000, 2007, if we take that period, have generics become stronger and more important?

MR PACE: Generics have become stronger, yes.

45

MR O'DONOVAN: Okay. And do you have any - do you know roughly market share between generics and - - -

MR PACE: I know what our business is, but I would rather speak about that confidentially.

5 MR O'DONOVAN: Sure, sure. All right. Now, it's been put to the Commission in some of the submissions that it received, that the picture in the egg - I suppose, firstly, that the egg market chain is a pretty simple one - there are producers that supply directly to retailers. So we are just focussing on the retail stream.

10 MR PACE: Yes.

MR O'DONOVAN: Producers supply direct to the retailers, and, effectively, they are the only two, I suppose, price points in the chain - that there's the producer and the retailer, is that - is that correct?

15 MR PACE: I am not sure - exactly sure what you are asking.

MR O'DONOVAN: Sure. Look, in terms of the process of deliveries to the retailer at a particular price - - -

20 MR PACE: Yes.

MR O'DONOVAN: - - - and that effectively represents a farm-gate price; is that right?

25 MR PACE: Look, I would say the majority of eggs produced in Australia are produced by, now, companies that are vertically integrated; so, you know, it's a competitive market out there, and I suppose margins from a regulated industry to a deregulated industry are definitely tighter, so you become more efficient, and to become more efficient, you need to control more of your supply chain.

30 MR O'DONOVAN: All right. And in terms of the part of a chain that an egg producer controls - - -

35 MR PACE: Yes.

MR O'DONOVAN: - - - they have the layers.

MR PACE: Yes.

40 MR O'DONOVAN: Growing them to a point where they lay eggs.

MR PACE: Yes.

45 MR O'DONOVAN: And then it's a matter of collecting and packaging the eggs.

MR PACE: Yes.

MR O'DONOVAN: And then delivering them to the supermarkets, is that - - -

MR PACE: Supermarkets or restaurants or fruit shops or whoever wants to buy an egg.

5

MR O'DONOVAN: Sure. And in terms of the distribution, do you control the distribution - like you have your own logistics?

MR PACE: Yeah, to a point. Years ago we did direct-to-store deliveries, but the larger retailers are now looking after a lot of their own logistics, so their own warehousing, so we would deliver to a warehouse and then they would deliver on to a store, but we still do, you know, the corner stores and - so we still do some of our own distribution all the way through the supply chain, but with the larger retailers, they now look after warehousing and distribution into their own stores.

15

MR O'DONOVAN: Okay. And does that assist in reducing your costs, them doing that part of the - - -

MR PACE: Yeah, I'd - that's probably - there's more to that than just looking at the cost of distributing the egg, so I'd like to talk to you about that outside of here, if I go.

20

MR O'DONOVAN: Sure. Yes, sure. Okay. So the - what's been put to the Commission is that effectively the price to producers has been very flat for 15 years.

25

MR PACE: Yes.

MR O'DONOVAN: Yet the price for - at the retail level has been shooting up at rates above the rate of the CPI, quite substantially. Firstly, has that been your experience, that - let's start with the first proposition, that processed prices have been very flat, egg-producing prices have been flat.

30

MR PACE: Yes. Look, going back to which point? Going back to 1990, I honestly - I haven't looked that far back.

35

MR O'DONOVAN: Sure.

MR PACE: In the, you know, the last few years, pricing has fluctuated a bit to the farm-gate price, and so, you know, some of the increases have been passed on, there's no doubt.

40

MR O'DONOVAN: Okay. So you are saying the farm-gate price has - - -

MR PACE: It has moved.

45

MR O'DONOVAN: - - - shown a steady rise.

MR PACE: It has moved, yes.

MR O'DONOVAN: All right. To reflect the increase in costs.

5 MR PACE: Once again, I don't want to go too much into it.

MR O'DONOVAN: Sure. Then in terms of the retail price that - to the extent that you are able to observe it or you follow it, have you seen dramatic above-CPI increases in the retail price that consumers are paying for eggs.

10

MR PACE: Well, the - once again, we are not in charge of the retail pricing, and I don't have a big enough field force to really keep my eye on it that closely.

15 It is not only though - see, the whole egg market though, and the dynamic of the egg market is changing with the more free range, more barn, more organic, so your cost basis is changing significantly as well, because to produce all of these lines has a very different cost base, and the cost base is higher. Once again, I don't want to go into the whole cost base.

20 MR O'DONOVAN: Yes, sure.

MR PACE: I'll talk about it outside of here.

25 MR O'DONOVAN: All right. So it's - so would it be fair to say that what - what you are observing is that there are more egg products out there - - -

MR PACE: There are more product.

30 MR O'DONOVAN: - - - which attract a premium price?

MR PACE: Yes, and I would say the generic-type egg is still a cheap product today; like, you look at - an egg's really not even 20 cents an egg.

35 MR O'DONOVAN: Okay.

MR PACE: Retail, at the lower end of the market, so, you know, I don't think egg pricing retail at the bottom end has moved that far.

40 MR O'DONOVAN: Okay. So if we just focus on a cage-laid generic egg.

MR PACE: Yes.

45 MR O'DONOVAN: You think that if we looked at it closely, we wouldn't see big above CPI increases in that product class.

MR PACE: I hadn't looked at it that close myself, so I probably can't comment. I'd probably need to have a look at it.

MR O'DONOVAN: Sure. But, instinctively, from what you know.

MR PACE: Instinctively from what I know, I don't believe they are ridiculously priced, no.

5

MR O'DONOVAN: If I can just - do you think - in your assessment, do you think it would be above - you know, have they been moving at higher rates than inflation, or do you feel it's been a pretty steady product.

10 MR PACE: Once again, if I go back to comments earlier, where it - where the pricing is a lot driven by supply/demand, and when we are in an over supplied situation, at times the cost of producing the egg becomes irrelevant.

15 If you've got truckloads of eggs that are in surplus, and they need to be sold, cost basis goes out the window. It's, "Sell them at any price, or dispose of them." It's hard to just look year on year with these type of products.

MR O'DONOVAN: Yes. Okay.

20 MR PACE: If it was a regulated - like, back in regulation days, when the industry was regulated, you are controlling the elements in a regulated industry, so you could look on year on year much better; but when you take that control out and you are in a free market - well, there are more variables thrown in, so just looking at a year on year, there's a lot more variables thrown in a free market.

25

MR O'DONOVAN: Yes. Okay, I think that's all the questions I've got.

CHAIRMAN SAMUEL: I want to ask just a few in public session, Mr Pace, and I won't go into the detail of your overheads or your price of supply to the retailers and the like, so I won't ask you to divulge that situation in public session, but how long have you been in the business?

30

MR PACE: Me, myself.

35 CHAIRMAN SAMUEL: Yes.

MR PACE: 20 plus.

40 CHAIRMAN SAMUEL: 20 years, okay. And I take it - well, would - you'd clearly know your price of supply to retailers?

MR PACE: Not over that 20 years, year on year, but today I would, yes.

45 CHAIRMAN SAMUEL: Yes, but as each year goes on, you'd know the price at which you are supplying your retailers, in whatever year it might be. The year 2000 - you'd know at that point in time of the price that, you know, the various categories of eggs were being supplied to retailers.

MR PACE: Yes.

CHAIRMAN SAMUEL: Including the cost of various logistic elements that - or supply chain elements Mr O'Donovan mentioned - that is, from the farm gate through
5 to packaging, through to transport.

MR PACE: Yes, as each year's gone on.

CHAIRMAN SAMUEL: Sure.
10

MR PACE: I suppose that data capture's got a lot better as well, than 20 years ago, where we were a very small family business, where today, obviously, you know, our data capture and cost base is getting a lot better year on year.

CHAIRMAN SAMUEL: And I do want to test it a bit further. If I took a dozen Pace free-range eggs - - -
15

MR PACE: Yes.

CHAIRMAN SAMUEL: - - - packed in a Pace package - and I've seen them.
20

MR PACE: Yes.

CHAIRMAN SAMUEL: You'd know what it was to supply that - you'd know the wholesale price and the price at which you are supplying that to the retailer.
25

MR PACE: Yes.

CHAIRMAN SAMUEL: That's what I'm - I haven't been explaining myself properly. I just wanted to make sure you know that.
30

MR PACE: Yes.

CHAIRMAN SAMUEL: And do I take it, do you ever go to the supermarket or to the retailers to buy eggs?
35

MR PACE: Yes, I do.

CHAIRMAN SAMUEL: And you'd see the price at which they are being sold at.
40

MR PACE: Yes, I do.

CHAIRMAN SAMUEL: And you'd, therefore, be able to quickly assess that those Pace free-range eggs are being sold at a retail price that, therefore, involves a margin of X over the price that you've supplied them.
45

MR PACE: Yes, I suppose I could do that.

CHAIRMAN SAMUEL: Do you notice any difference in the margins between year on year? Have you noticed any dramatic changes in the margins between your price of supply to the retailer, and the price at which you can buy them off the supermarket shelf?

5

MR PACE: I'd have to say year on year, no. Look, I haven't been doing this role for 20 years. You know, I was more on the farm, then I've come through working in the operation. You know, working on the packing floors, you work seven days a week a lot of the time, and I probably didn't go to a supermarket for years, to be quite honest, so year on year, just sitting here I couldn't tell you. I'd have to go back and do a lot more investigation on it all, but as of where we sit today, you know, later on we can go through that information a bit more.

10

CHAIRMAN SAMUEL: And your current role you've had for how long?

15

MR PACE: Nearly three years, two and a half years.

CHAIRMAN SAMUEL: Okay, thank you. I suppose I could ask you in the last three years, have you noticed - because that would be a period of time that you would notice - the factors such as the price of supply to the retailers - and I am not just talking about the major supermarkets, I'm talking about to retailers generally - and the price at which they've been sold off the shelf, did you notice any difference in the margins that have been charged, or being earned by the retailers in that three-year period of time?

20

MR PACE: I think the margins are probably remaining static. It's just the price. The base point's going up because of cost increases.

CHAIRMAN SAMUEL: And in the period preceding that three year period that you've held your current position, were the positions you were holding in Pace Farms such that would enable you to make an assessment of what had been occurring with the retail margins in those preceding years?

30

I'm just trying to get a - look, we can get this detailed information from you and from the retailers, but I'm just trying to get a bit of an assessment from yourself as a supplier, as to whether you've walked into a red-house store and said, "My golly, that margin's really, you know, much higher than I ever expected it to be."

35

MR PACE: Yes. No, look, I don't understand how a cost base - so I don't even know - I know what the gross margin maybe is, but then there's also promotion times, this, that and the other, so to assess it on a one shop, go in and have a look at it on that day - I don't believe you can do that.

40

CHAIRMAN SAMUEL: Okay.

45

COMMISSIONER MARTIN: Just in terms of how you distribute the product to retailers, do you just deliver to the warehouse, or do you deliver to individual stores.

MR PACE: No, to warehouse.

COMMISSIONER MARTIN: In all cases?

5 MR PACE: In two of the larger ones. In one of the smaller ones, we do go direct to store.

COMMISSIONER MARTIN: And with the smaller one, that's - that would be Metcash/IGA, is it?

10

MR PACE: No, it's Franklins.

COMMISSIONER MARTIN: Okay. The - and what about the other side of the business. How do you distribute - you said there's both the manufacturers and the wider general market. How do you distribute to them?

15

MR PACE: Look, where we can, we have our own transport, but we also use some contracted carriers, but for the - - -

20 COMMISSIONER MARTIN: Are there intermediaries in that business?

MR PACE: There would be on some of the food service-type sector, yes, so we don't get to the end user with every sale that we do. There are wholesalers, et cetera.

25 COMMISSIONER MARTIN: Thanks.

CHAIRMAN SAMUEL: All right. We'll go into private session. If you are not connected with Pace Farms or the ACCC, I ask you to leave the room.

30

ADJOURNED

[3.30pm]

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CONTINUED FROM TRANSCRIPT-IN-CONFIDENCE

RESUMED

[4.32pm]

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MR SAMUEL: Okay Mr O'Donovan, I hand over to you and you can have the witnesses and introduce their names, et cetera.

10 MR O'DONOVAN: Okay, could you just each introduce yourself?

MR CARTER: I'm John Carter. Do you want background, do you?

15 MR O'DONOVAN: Just your role in the – who you're representing and your role.

MR CARTER: I'm representing the Australian Beef Association. I was the Chairman, I was a Churchill Fellow in Meat Marketing and I chaired the New South Wales Meat Industry authority for ten years.

20 MR O'DONOVAN: Okay.

MR ECONOMOU: My name is Athel Economou. I'm a director of the Australian Beef Association.

25 MR O'DONOVAN: Okay. Now I understand you have a short presentation you want to give upfront?

MR CARTER: Yes, if that's permissible.

30 MR O'DONOVAN: Yes, please, go ahead.

MR CARTER: Thank you, Mr Chairman. We're looking at not a short-term variation which the ACCC looked at back in February last year. We're looking at a long-term situation and we're comparing our situation here in Australia with the
35 American one. The US consumer is paying half what the Australian consumer pays and gets a far better graded product. The US producer is paid from 25% more for the finish steer, 45% more for the feeder steer, the unfinished animal, more than its Australian counterpart.

40 The UK producer gets twice what the Australian producer gets, yet the UK consumer pays the same as the Australian consumer. So what we are saying is that the Australian consumer and producer are both being rorted.

45 The figures we've worked out, Athel has worked out, we're looking at around \$4b being paid more by the consumer per year and the producer getting \$2b less if our Australian meat chain was as efficient as the American one.

The people in the chain, the producer here in this country, is basically going out backwards. Farm labour has left in large quantities on recent NFF survey. The average age of the cattle producer is over 60.

5 The costs have exploded. Fencing material, et cetera, have all increased. The supply chain from the producer on we've got a duopoly in the agency industry with landmark and elders with connections with the feed lot and the Japanese link. Transporters, we've got fierce competition and it's hard to believe that they can be improved upon and people talking about the large distances we've got here are quite wrong. The concentration of cattle and of people in Australia is all along the east coast which is far smaller distances than across the United States.

15 Saleyards competition, we've got problems with cartels in the saleyards. It's only a relatively small part of the overall equation, but it's serious and Australia needs a stockyard and packers act which the Americans have had since 1921.

The feedlots are a recent and economically doubtful edition. They're now operating at under 50% capacity, and in a general good season with high world grain prices that will be lower.

20 The C3 yearling carcass weighing over 200 kg with 8 mm fat is reported and priced exactly the same irrespective of his or her feed regime. The Japanese US companies control the majority of Australia's feedlot capacity and we have got problems there, but I think feedlots will become a lesser part of the equation.

25 Abattoirs are mostly unprofitable. Very few new works have been built since public works were built in the 1940s/1960s, we've had upgrades and we've only got one export plant very badly run west of the line between Townsville and Adelaide which is two-thirds of Australia where there were once eight.

30 Retail is where the huge change has occurred. In 15 years Coles and Woolworths moved to dominate and the profits are lying there, and when you compare them with the American situation where you've got over 50 supermarket chains, we can understand where the problem lies.

35 Our conclusion, the retailer and the Japanese situation are taking a disproportionate share of the consumer dollar and putting at risk the sustainability of the industry and we'll be calling a Royal Commission into the meat industry chain because we fully appreciate the ACCC is handling an enormous number of commodities going through supermarkets and hasn't got the resources to go right into it, but that's our opening address, thank you.

45 MR O'DONOVAN: All right. Can I just ask you first to briefly describe what the AVA is, who its members are, who it represents and what its role is?

MR CARTER: We've got members across Australia, we've got around a thousand members. They range from, the largest has got 120,000 cattle and the smallest

probably might have 10 or 15. They reflect the industry at the annual general meeting of the meat and livestock Australia, we've got on some occasions more than 50% of the vote. We represent the thinking of a lot of producers.

5 MR O'DONOVAN: Okay, so that's cattle producers?

MR CARTER: Cattle producers, yes.

10 MR O'DONOVAN: And in terms of your own experience, have you worked in the beef industry yourself?

MR CARTER: I most certainly have. I've been a cattle producer all my life, 50-odd years, but I did a Churchill Fellowship into meat marketing, spent three months overseas in 1983 studying the entire meat chain and when I came back I was
15 fortunate enough to be made Chairman and Chief Executive of the NSW Meath Authority, and I then concentrated on making – trying to make the whole chain more efficient from the transporter right through to the retail. That finished in 1994 and I'm still a producer at Crookwell, and I certainly understand the industry. My son is heavily involved in exporting and we've got the oldest firebrand in Australia.

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MR O'DONOVAN: Okay. Now as I understand it, there are a few different routes to market in the beef industry, one of which is to sell product through the saleyards. Can you just describe to us how the saleyards work and why you'd sell through a saleyard and what sort of quality of animal goes through a saleyard?

25

MR CARTER: Well, a saleyard is an assembly point. Abattoirs, most of the processes where they're buying cattle, they want to buy in semi-trailer loads, and many of Australia's producers, as the Americans found out, are very small producers and they only send in small lots, so they've got to be assembled in a saleyard and
30 that's their purpose. When the Canadian pig industry went to try – to direct selling, they found that they had to have assembly centres put up because there were so many small producers, and that's what it's about.

35 Interestingly enough, the Americans did a survey last year and they actually found that there was a 12% – not 12 – 12 cents higher price through the saleyard or sale barn than in direct sales because they've got a very good marketing system under the Stockyard and Packers Act. Every sale must be advised to the USDA, the reason being, of course, that there's competition. You've got other producers bidding against processes and that's the key to the saleyard and our saleyards are becoming
40 much more rationalised, we're getting smaller centres going out and the competition at the big yards is quite good, but the smaller ones is not good at all because there are cartels, and the alternate system is to sell direct to a works, but you've got to have a large enough consignment to warrant the sending of a semi-trailer or a road train, and the downside with that is that you can be heavily discounted if you're selling to a
45 grid, certain specifications of fat depth, weight, et cetera, and if you go outside the grid, you could be very heavily discounted, and when that happens you've got no

redress because the animal's dead whereas at a saleyard you can always say no sale and take it home.

5 MR O'DONOVAN: And at present is the saleyard still a place where ultimate retailers or is there only the processing part of the industry that actually buys there, or do the vertically integrated retailers buy there?

10 MR CARTER: They all have a presence there. In the ACCC's earlier thing they were talking about the supermarkets not operating very often there. It varies greatly. In the south I would think that the saleyards is by far still the dominant means of selling cattle. In Queensland where there are very large holdings, they sell over the hook and they wait for the opportunity to have their cattle killed, they book in and the saleyard is a lesser operation in Queensland.

15 MR O'DONOVAN: So it's for the selling of live cattle in the saleyards?

MR CARTER: Yes.

20 MR O'DONOVAN: Now tell me about over the hook. When you're selling something over the hook, what's the process for that?

25 MR CARTER: Well, you send them to the abattoir at the agreed date when they've got time to kill it, you've got to fit in, and then they're giving you a price for a grid, a certain type of suede, fat depth, and they may put other things in it, but those are the two dominant criteria, age too, the teeth, and then they'll kill them and you'll get a cheque less the discounts that they pulled in.

30 MR O'DONOVAN: Okay, and that's from the meat processor, or is that from a vertically integrated retailer or?

MR CARTER: That's from the meat processor. None of the vertically integrated Coles or Woolworths actually own abattoirs that I'm aware of. They all operate through the Cargills or Australian Country Choice or JBS, et cetera.

35 MR O'DONOVAN: Right, so they don't take any ownership of any animal until after it's slaughtered.

40 MR CARTER: They may have some in feedlots, I'm not quite sure of that, but as I've said, the feedlot issue has diminished greatly because of the price of grain. The economics of feeding cattle are extremely questionable with grain prices as they are.

45 MR O'DONOVAN: So would it be fair to say that the bulk of cattle produced for beef in Australia either go to a saleyard or direct to an abattoir for sale over the hook, and those are the two options that a cattle grower has?

MR CARTER: The third one is to sell to a feedlot where the animal is then grown out to another market, whether the food lot is feeding for a feedlot, feeding long-term

for Japan. They're the two main outlets through feedlots, but as I said, feedlots account for, I think capacity somewhere got up to about 900,000, well Michigan in America's got more cattle and feed than that. We're very, very small in the world scene on feedlots and we're likely to remain that way just because of the economics here in Australia.

MR O'DONOVAN: Sure. Now do you know at what point the major supermarkets enter the beef market? Do you know at which points they're acquiring beef within the supply chain?

MR CARTER: Well they've certainly been getting, up until the last big fall in the amount of cattle on feed, are getting a lot from feedlots, but they'd also be getting a lot of other beef. They sell mince, mince being one of the most common items on the shelf, and a lot of that comes from older cattle. We worked out –

MR O'DONOVAN: Would they be acquiring that as mince from a processor or would they have it already packaged by someone else and then acquire it from then?

MR CARTER: I would have thought mostly packaged, yep. Certainly from a processor, but perhaps on the way it would have been treated I would have thought.

MR O'DONOVAN: So would it be fair to say they're not strongly influential at the bottom end of the chain, if that first transaction where the cattle producer sells, either it's a live or dead animal?

MR CARTER: The greatest influence is on young cattle because the majority of the cattle that they sell for cuts are what we call milk or two-tooth cattle; in other words, cattle that are under two years old or under two and a half years old, and we believe that they would buy 50% of those.

MR O'DONOVAN: Direct from cattle producers?

MR CARTER: No, mostly from feedlots or further along. They certainly do buy them in the saleyards, yes, but whether they – I mean if they're well enough finished, clearly they have them killed and they go on, but if they're not well enough finished, well they should go into one of their feedlots.

MR O'DONOVAN: All right, but you don't have any direct information about their buying practices?

MR CARTER: Well, only what one observes. One knows that certain people buy from Woolworths, certain people buy for Coles and they certainly operate in the saleyards and it's one of the problems. I was very influential in getting market reporting going back in the late 1980s and we had terrible trouble and still have terrible trouble as otherwise understand it getting any information, any price transparency on any of those things that don't actually pop in the saleyard.

MR O'DONOVAN: Right, but the people that you see operating, you don't know whether they're operating as buyers or agents or in what capacity they're acting in relation to the supermarkets?

5 MR CARTER: In the saleyards one does, but I certainly would not be aware of what they're doing privately.

MR O'DONOVAN: Right, okay. So in terms of the saleyards there are agents of Coles buying, Coles or Woolworths, buying on their behalf?

10

MR CARTER: Yes.

MR O'DONOVAN: Animals that have passed through those saleyards?

15 MR CARTER: Yes.

MR O'DONOVAN: You mentioned that there were some cartels in the smaller saleyards.

20 MR CARTER: Yes.

MR O'DONOVAN: What do you mean by that?

MR CARTER: Well, I mean be specific, look at Goulburn, very often only two bars
25 there for, perhaps, four or five hundred cattle and they've got, perhaps, six orders each. That's not exactly what you'd call competitive and that tends to happen more and more in the smaller saleyards because the actual processing industry, of course, is also contracting in that we've now got really – well, we've gone from around 250 abattoirs, perhaps six/seven years ago and I think we'd be down to about 120 now.
30 In many ways that's a good thing in that they do need through-put to utilise the bi-products properly. But it certainly reduces the competition in the saleyards.

MR O'DONOVAN: Right, but presumably if the supermarkets are buying in the saleyards and the abattoirs are buying in the saleyards, there are enough participants
35 in the market to make it an effective market?

MR CARTER: Well, until you turn and see the amount they're paying, I mean in theory it would appear so, but when one looks at one's stock book and when one looks at the falling prices that one cow calf producer, like myself, has been getting
40 over the last six or seven years, there's something wrong through the system. Now whether the saleyards is just a reflection of something further on, which I believe is the case, or not, I believe that is the case. It's a question of what's going on further along.

45 MR O'DONOVAN: Sure, but if the saleyard system's not working, there's the option to sell over the hook, is there?

MR CARTER: Yes, it's a closed sort of situation, though. You've lost control of your animal as soon as it goes out through the gate.

MR O'DONOVAN: Right, but –

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MR CARTER: The option is there, as long as you've got enough, and hopefully you've got a good relationship with the processor, but there's been – some people have got no alternative. Most people in Queensland have got no alternative.

10 MR O'DONOVAN: Alternative to what?

MR CARTER: To selling direct to an abattoir.

MR O'DONOVAN: Right, as opposed to through a saleyard?

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MR CARTER: Yep. See Queensland has now got half of our cattle and you've got a saleyard in Townsville, you've got a saleyard in Rockhampton, a big one, a very big one, and Roma in the south, but most of the people do have to sell direct to a limited number of abattoirs, very limited number and a very limited number of companies.

20

MR O'DONOVAN: So are you suggesting that if there is a competition problem that it may be at the abattoir level not at the supermarket region level?

25 MR CARTER: No, I think it's at the retail level because I think the – it feeds right through. They are basically controlling the domestic market for the young cattle and if they're not paying enough there, the Japanese are not going to pay enough there and so we're getting the prices we're getting.

30 MR O'DONOVAN: Can I just take you through that. My understanding is that more than two-thirds of beef grown in Australia is sold for export; is that –

MR CARTER: Around 60-odd%, yeah.

35 MR O'DONOVAN: All right, so close to two-thirds of all cattle grown here isn't sold for domestic consumption?

MR CARTER: That's correct, yep.

40 MR O'DONOVAN: So it's an internationally traded commodity?

MR CARTER: Well, most of what we sell overseas is what we call manufacturing beef whereas when we start talking about the higher quality beef, we're looking at younger beef from – well, certainly from south of Rockhampton. So it's not quite as simple as it sounds. I mean there's huge quantities.

45

If we take JBS's support, AMH, which was the biggest, and JBS got a good record of value adding, there'll be cooking and we're hopeful that they do what they've done in the Argentine and Brazil here, and I guess the Americans are hoping they're going to do it there, they'll value add, but basically AMH, if it went to Dinmore abattoir, nearly everything was going away as manufacturing beef. It's not high quality beef on the world market at all, that's why we get – well, we get less than the Americans in Japan and in Korea.

MR O'DONOVAN: Sure, so there are some elements of it, you say, are not prime beef consumption?

MR CARTER: Majority, the majority.

MR O'DONOVAN: Sure, but there is a substantial market, for example, the feedlot, beef grown for sale to Japan, that's part of the export market?

MR CARTER: Sales to Japan, but it's still a very small percentage of the total. If we're killing 8 million head a year, well they were talking about 30% going through a foodlot, it would be well down on that now, but I don't know how – what the split-up is between the – what's going to Japan from food lots and what's going to the supermarkets. I don't think anyone's calculated that.

MR O'DONOVAN: Sure. But just focussing on what we do know, we do know that two-thirds of cattle grown here go overseas on to an overseas market?

MR CARTER: Yep.

MR O'DONOVAN: Some of which might be manufacturing, but some of which is –

MR CARTER: Most is manufacturing.

MR O'DONOVAN: Sure, okay, and then of the remaining one third, so we're only dealing with one third of the cattle grown in Australia, two-thirds of that is sold to retail, so there's still one third that goes off into restaurants and fast food restaurants; is that your understanding?

MR CARTER: Well, certainly some goes out to fast food restaurants, but that is not high quality beef in the main. If you take McDonald's they've got a third of a patty is from younger cattle, but probably two-thirds is from older cattle, which is very definitely manufacturing beef.

MR O'DONOVAN: All right, but in terms of the proportions of that one third, there must be supply to the restaurant trade?

MR CARTER: Well, there would be and that's done through people like Beak and people like that who actually cut the beef up and package it for restaurants. But the

really large purchases of these young cattle are basically the supermarkets because they've got the largest share of the domestic market.

5 MR O'DONOVAN: Sure, okay, but – well, again the figures seem to suggest that they have only half of the domestic retail market; would you agree with that figure?

MR CARTER: I just have to go along with the figures. I certainly haven't done any research myself.

10 MR O'DONOVAN: Yeah, no that's right, but in terms of the published figures?

MR CARTER: Yes, that's fine.

15 MR O'DONOVAN: All right, so in terms of the market that they occupy, the domestic market is only one third. The retail market is only two-thirds of that. They only have control of after of that, so we're dealing with – in terms of beef produced in Australia, they're, perhaps, a fraction over 10% of the market, the major supermarkets, Coles and Woolworths.

20 MR CARTER: Yeah, it's a different market.

MR ECONOMOU: It seems to me you're referring to that pie chart on page 6 of the last report you did in February 2007, and that suggests that of the total meat processed in Australia, that the supermarkets have a collective share of 12% and
25 about half each, 6% each, so they're not a force in the market in that they only buy 6% of the total beef killed in Australia.

The reality is, though, that a third of all the cattle in Australia are old cows, they're not what we eat, they're not actually the same product. So you can take them out.
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Then you can take all the 5 and 6 and 7-year-old bullocks out of western Queensland and the Northern Territory and the Kimberley. They're not things that we eat. You take them out.

35 You look at all the cattle that are captive supply for the Japanese which are destined for long and short-fed markets in Japan, you take them out, and then you're looking at what we eat, and what we eat is beef from animals under two years of age, derived from carcasses around 200 kg. Right, that's what we eat.

40 So that's what's left that we eat, and the supermarkets buy half of that, so to suggest that they only buy 6% of the total meat thing isn't a fair way of dividing up the market. It's almost naïve. The thing is they're in there buying 50% of all the young cattle processed in Australia which is what we eat. We can't eat the stuff that goes to America. So they've got an absolute position of buying half of all the young cattle
45 and between them they buy half of all the young cattle, so that means all the other people who buy one and two and three and four per cent of the young cattle have to deal with this dominant pair of buyers, and that's where the domestic market sits and

I hope I've explained it as best I can, but that's where we are and that's what we've got to deal with, this two buyers who buy half the domestic category of cattle.

5 MR CARTER: That's what we're referring to table B. I mean we do eat cows. We
mightn't know it, but we do in the mince that you will get and there's a lot of it, but
there's no question we keep getting back, we should get back, to a benchmark which
is the efficiency of the American system. Now their consumers pay twice what ours
is and their producer is getting between 25 and 45% more than ours is, and we go
10 down through the chain, we've got a problem with just two agents and particularly
the relationship with Japan and one of them, and we really haven't got any real
problems that we can see until we get to the retail area and that's where we believe
the huge mark-up is and the retail butcher is still out there competing, but so many of
them are in shopping malls who are paying – and they're paying exorbitant rent for
15 their shops, and so consequently they've got to charge a lot more money than clearly
the Americans and so we've got a situation where the Australian consumer is really
being taken for a big ride.

MR O'DONOVAN: But if I could just take you back to, I suppose, what was called
20 now a subcategory of the market, which seems to be meat that's destined for
consumption as a piece of steak or the like?

MR CARTER: We refer to it table beef.

MR O'DONOVAN: Okay, table beef. We're talking about table beef for a moment.
25 In terms of the producer, they're dealing there with a commodity that can be
purchased by the Japanese or can be purchased by the Americans.

MR CARTER: By an American multi-national abattoir can buy it. The Americans,
not too many of the Americans are actually taking out table beef, that's a very, very
30 small percentage of our market to the United States, it's nearly all manufacturing
beef, but we've still got – you know, the multi-national abattoirs operating, but
they're operating on behalf of people all around the world, including Coles and
Woolworths and Australia.

MR O'DONOVAN: I suppose what I'm trying to understand is from a cattle
35 producer's point of view, if they feel the prices that are being offered domestically
are unsatisfactory, are there opportunities outside of Australia to export their
products and get a better return if the commodity, you know, if there are buyers
willing to acquire the commodity?

40 MR CARTER: It would be undercut by all the other producers and processors
competing against you. I mean I think our Chairman referred earlier that we
shouldn't give evidence damaging our competitive position. Well I'm a cow calf
producer and I haven't got a competitive position. I've got all these other cow calf
45 producers competing against me, so if I say "Look, I'm going to want more money
because I've got a niche market in North Korea", those people in North Korea are

not silly, they'll soon see what the market price is and they'll put me back to that or go somewhere else.

MR O'DONOVAN: But it's an international market price.

5

MR CARTER: Well that's our problem. We're below the international market. If we look at it from an American angle or from a Japanese angle where they're getting, god knows how many times what we're getting, or a European one where they're getting so many times, and we're all very concerned that perhaps Brazil will make it very hard for us, but their price has now gone right up too, but we're right down the end.

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MR O'DONOVAN: Can I just focus on the beef that you produce.

15 MR CARTER: I don't really produce beef; I produce cattle cows and calves.

MR O'DONOVAN: In terms of once you've got cattle that's ready for sale, which route to market do you opt for?

20 MR CARTER: Well I keep experimenting. I've sold direct to various abattoirs and if you want to get really depressed, I can read you the actual sales that I had in the last financial year and we've had markets drop 30 cents from the week before, I sold direct to an abattoir and they dropped the price after we'd basically agreed that that's when they were coming, by they said "No, the market has changed" and dropped 20 cents a kilo. So you shop around. You can use – well, you can use Auctions Plus which is a computer-type of selling. There are plenty of different ways you can try, but there's no sure way of getting your money.

25

I had one of the senior Woolworths buyers sitting beside me in a meeting some years ago and I complained about the price I was getting and he said "Surely you put the price on and your profit margin?", and I said "If I had to put my profit margin on, you would not be in the game". The producer is just a price taker.

30

MR O'DONOVAN: And in terms of where the cattle sold to the abattoirs that you deal with, are they all selling onto the domestic market or are they selling onto the international market?

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MR CARTER: All my cows, obviously, go split, some of the beef goes into hamburgers for the overseas market and some for the domestic market hamburgers. My young table beef that I get finished will all go on the domestic market and may be killed in an export works, maybe killed in a domestic works.

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MR ECONOMOU: With regards to production, to be efficient you've got to target, you know, you've got to actually customise your production system to your environment and then you've got to target a market, and you target a market by having the right genetics and then finishing at an appropriate market-specified weight fat, weight for age sort of situation. So when you set yourself up as a producer, to

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lower your costs you set the whole business up and target a market. Now beef cattle are a perishable product. They hit the specification in terms of weight and fat cover, and they're only there for ten days. Beyond that they get too heavy, or get too fat, or if the season collapses, they get too thin. So you've only got that fleeting chance to
5 actually sell your animal when it's in an appropriate market condition, but then you've got to deal with the fact the market is going to be going up and down, as it happens.

Now the other thing is the seasonality in Australia means that most people can
10 produce pretty good cattle in the spring or the end of spring or early summer and then, of course, it's very difficult to hit the specification at the end of autumn because the feed situation's been bad. So you can't actually choose, when you finish an animal and it weighs 400 kg with 6 ml of fat and it's 18 months or 16 months old, you can't actually decide to send it to Japan. It's only suitable for the domestic
15 market or the default position is to be ground up into hamburgers and sent to America, but that's a much lower value market, so there's not a lot of flexibility. That's just the reality of it. The animal's ready for one day or for ten days, and then all of a sudden it's off spec and it's costing you money to keep it. So it's not like you can pick and choose where you go. You design it for a purpose and you've just got
20 to take the price on the day when it gets there.

MR O'DONOVAN: Sure, but in terms of your planning at the start of the process, 12 months before, you could have decided – isn't there a market opportunity to decide "Well, I want this to end up in Japan as beef at a very high retail price?"
25

MR ECONOMOU: You can, if you start to do that, but again it's only ready on the day and you've got to take the price on the day when it's ready.

MR O'DONOVAN: Sure.
30

MR ECONOMOU: And look, there's a number of slots you can go for, but I'm just saying you can't change midstream.

MR O'DONOVAN: No.
35

MR CARTER: And you've got to have a very large volume because if you start doing a contract with somebody, they expect continuity of supply, and the average producer there's no way they can do that, except in Queensland where they – it's not continuity, but it just keeps flooding out in the right season, but the feedlot was the
40 way of trying to get continuity of supply, but now the economics of that are in trouble, but I'd just like everyone to get back to the fact that the American consumer is getting a better product at half the price and the American producer who's producing exactly the same genetics that I am, and the same weight as a feeder steer, is getting 25 to 40% more than I am. So we've got an incredible difference in the
45 efficiency of the American beef chain and the Australian, and then we go down the chain and we find two areas where we believe strongly where the difference lies. I mean the US, with all those supermarkets, has got much greater competition.

MR O'DONOVAN: But if you look at the costs of finished beef, there's a huge amount of costs between the original, I suppose, purchase of the animal and the delivery of it on a tray to a consumer; would you agree with that?

5 MR ECONOMOU: But the cost is no different. Or not the cost, the processes are no different between the States in Australia. They still do exactly the same job.

MR O'DONOVAN: I'm just trying to understand. There is a substantial amount of processing that happens between a live animal and a steak on a tray?

10

MR CARTER: Yep, absolutely, yep.

MR O'DONOVAN: And there are multiple points within that process in which the supermarkets are not directly involved in Australia.

15

MR CARTER: Correct.

MR O'DONOVAN: Sorry, just let me finish this.

20 MR CARTER: I'm sorry.

MR O'DONOVAN: And there are opportunities for efficiencies throughout that chain which may not be happening within Australia, but are at other levels at the processor level; would you agree with that?

25

MR CARTER: Well we certainly agree with your position that there are costs in between, but when the Australian producer, the cow calf person like me, is getting 28%, roughly, of what the Australian consumer, which is also me, is paying, and the American, as of last month, was getting 45% of the price that the American consumer is paying, there's clearly costs in between, but the supermarket or the retailer, retail butcher, is part of that chain and all our arithmetic points to the biggest cost in the chain, whether it's being profit or expense in the shop, lies with the retailer.

30

35 MR O'DONOVAN: All right, well what's your evidence for that? What evidence do you have about retail margins in meat as opposed to processing, as opposed to transport, as opposed to abattoirs?

MR ECONOMOU: I think you've just got to look at the profitability of the various components of the chain. Clearly supermarkets are highly profitable businesses. We've seen the failed supermarket in Australia, Coles, just change hands for an enormous amount of money. Their share value has gone up astronomically despite being the failed supermarket, but how many processors are publicly listed companies in Australia? There's none except for the Brazilians who have just come in now.

45

You know, how many farm businesses are publicly listed? There's only one publicly listed cattle company in Australia, AA Curry.

MR CARTER: And half of it's trying to get out.

MR ECONOMOU: Yeah, but the thing is the profitability of the meat chain, except for the retail end, which has been astronomically profitable as retailing, the rest of
5 the chain just cannot attract capital.

Now but worse than that is the fact it can't attract people, like agriculture is dead in the water in terms of human resources. We just don't have any smart people. The TER score to get into a university agricultural course is almost zero. No-one wants
10 to go into agriculture because we pay pathetic wages. The NFF is complaining that we can't get people, we're going to have to import people, and that's common to other businesses, but you know the wages in agriculture are so low we can't compete with any other industry in Australia to get people.

15 I can't answer the question directly where the cost is; I can just say where's the smart money going? It's not going into process, it's not going into farming, it's certainly going into retail, and I think that's, you know, that's the evidence that we've got a problem.

20 MR O'DONOVAN: So it's just based on the value of the supermarket as a business?

MR CARTER: No, we've got the US figures. I mean there's no question that the US consumer is paying half what the Australian consumer is, for a better product, and the US producer is getting 25 to 40% more, that's the cow calf man producing
25 exactly the same thing.

So we've got clearly a very inefficient chain, we go through the chain and we look at who's making money in the chain and we see lots of people who are not making money in the chain, certainly the abattoirs aren't. So the only conclusion one can
30 reach is that this huge gap lies in the retail area.

MR O'DONOVAN: Now have you seen data produced by meat and livestock association which suggests that the, in terms of saleyard price as compared to retail price, oscillates around the 40% mark sometimes as high as the 50% mark for lamb and beef?
35

MR CARTER: Well, I haven't seen it, and if I did, I would be extremely annoyed simply because the meat and livestock Australia tells me annually that in return for my \$5 per head which I'm levied and the 37-odd that I've got to pay for the open
40 national livestock identification system, that they are increasing the price paid by the consumer. That's what they say every year. They do a survey and they say "We've increased the price paid by the consumer", and I say "Well, that's just great". I'm getting less money, but I've got to pay a levy, I've got to pay all this, and when I go to the supermarket I've got to pay more, so I'm a three-times loser and so we're very
45 critical of meat and livestock. Australia's – I've been trying to get them to do an audit of the industry for ten years, or their predecessors before them, so that we knew exactly what was happening in the industry, but we're getting this constant thing that

the consumer is paying more, therefore this is good for the producers. Well, it isn't. The producer is not getting more and he's paying for a lot of the advertising by the retailers.

5 MR O'DONOVAN: But you don't have any – so you don't have any comment on whether those figures are right or wrong?

MR CARTER: I would think they're based on hot air simply because they haven't done an audit. We've been trying to get them to do an audit and until you really
10 audit an industry, it's very hard to make any claims at all, because a lot of their claims are made on consultants' surveys.

We've got a classic example in the ACCC's examination of prices done in February. They're talking about the domestic consumption, MLA figures. Well they're wrong,
15 they are hopelessly wrong. They're given as carcass weight in this which MLA gives them as, but that is not domestic consumption. You can take 30% off that. The Americans work on actual domestic consumption, but we're working on domestic disappearance. The difference between the amount of beef we sold
20 overseas, the amount that was weighed in the abattoirs, the amount that was sold overseas and what's left is domestic consumption. That includes all the bone, the dog food, the whole works.

So their figures are really not to be relied on. I wouldn't believe in a fit that the producer in Australia was getting 40% of the retail price. I suggest it is somewhere
25 between 26 and 30% and I got the American figures going back for ten or 15 years and I've got no doubt that what I'm saying's right.

MR O'DONOVAN: All right. Now in your submission you indicate that Coles and Woolworths compete with each other primarily on price, and that a price war has
30 been waged for more than a quarter of a century; do you recall writing that in the submission?

MR ECONOMOU: Yes, I wrote that.

35 MR O'DONOVAN: Which does suggest that, at least at the retail level, there is a level of competition from which consumers benefit. If there's a price war, presumably the price is – each is forcing the other one's price down to a point where consumers are benefiting.

40 MR ECONOMOU: The price thing is relative. As we've said before, American farmers get paid 20% more and American consumers pay half as much; okay. In Australia the supermarkets are generally cheaper to buy meat, undifferentiated meat, than it is in an independent butcher shop, and yes they've run a price war to be the cheapest between themselves, and as I've said in there, they pass the cost of that
45 price war back down their supply chains and that's because they control 50% of the market between the two of them.

You know, our beef unfortunately is expensive because we haven't invested in the supply chain and the whole system is inefficient, but in a relative sense the supermarkets are cheaper than independent butcher shops, but collectively the whole thing's really expensive.

5

MR O'DONOVAN: But from what you're saying that seems to suggest it's an inefficient supply chain that's the source of the problem not a lack of competition at the retail level?

10 MR ECONOMOU: Well I'd suggest that the inefficiency in the supply chain is due to a lack of investment and that's investment in money and people, and the reason for that lack of investment is because every time anyone pops up and tries to invest, you know, the price war is imposed on them and we've heard people even today talking about the strategies, the pricing strategies. As soon as you try to differentiate your
15 product upwards, all of a sudden there's cheap meat everywhere within a hundred miles of your shop and that's been going on for 30 years. We don't have a grading system in Australia. All meat is one standard. Like there's no differentiation. Every other civilised has a grading system: best equation; the worst quality, with about five grades in the middle. We don't have that. Meat is dealt as a commodity and that
20 really suits the volume of people and that's the culture we've lived in and that's the commercial culture we operate in and the net effect of being to make the whole thing really inefficient because we haven't had the investment.

MR SAMUEL: I'm just very conscious of the time. We have two other witnesses.
25 Have you got anything specific that you want to ask?

MR O'DONOVAN: That was the last one.

MR SAMUEL: Gentlemen, I just want to clarify a couple of things because I'm just
30 not sure of the conclusion we've reached as a result of the discussions that we've just had. Is it the supply chain that's the problem or is it the retail margins and retail profitability that's the problem?

MR CARTER: The retail profitability is part of the supply chain, and we believe it is
35 the least price effective as far as the consumer is concerned; in other words, there is more waste in the chain of getting the beef from myself to the consumer at the retail level than any other part of the chain.

MR SAMUEL: Right, okay. Can you, because you've talked, I think, of the
40 profitability of the supermarkets, the major supermarkets, and of high values being placed on Coles in its recent acquisition by Wesfarmers Group, have you got there the gross margins and the EBIT margins of the three major listed entities in this business in Australia; that is, Coles, Woolworths and Metcash?

45 MR CARTER: No.

MR SAMUEL: But, sorry, you were making comments about the – I'm not trying to cause you difficulty, but I'm just trying to understand if your comment upon its profitability, I'm just trying to understand you in terms of the published information about Coles, Woolworths and Metcash and it's their gross margins and their EBIT margins.

MR CARTER: I'm basically talking about the whole chain and the fact that we're paying twice as much as the Americans and the fact that the other members of the chain are, we know, are not making a profit.

MR O'DONOVAN: Have you done a study of the gross and EBIT margins of the US retailers?

MR CARTER: No.

MR SAMUEL: And have you done a study of the gross and EBIT margins of the Australian retailers?

MR CARTER: No, I'm just doing it by logic.

MR SAMUEL: But these would be published figures. I'm just trying to apply a different logic which would be the published audit accounts.

MR CARTER: We've got the USDA figures of retail prices in America, if that's what you mean, yeah.

MR SAMUEL: How did the gross and EBIT margins of US retailers compare with the gross and EBIT margins of the Australian retailers?

MR CARTER: I haven't got figures on the margins of the Australian retailers or the American ones, but I do know what their prices are in America because the USDA publishes them every month. That's just the price. We're talking about the inefficiencies of the chain and the only conclusion that we can come to is that the largest wastage in money between myself and the consumer lies in the retail sector.

MR SAMUEL: Wouldn't that be reflected in the comparison of a gross margin as against an EBIT margin of a US retailer or retailers across the board and the gross and EBIT margins of the Australian retailers. I'm just wondering if you've made those comparisons.

MR CARTER: We haven't.

MR SAMUEL: Because that would be the most accurate reflection, would it not, in audited accounts, published audited accounts of efficiencies in the retail end of that supply chain.

MR CARTER: Do you mean to separate the meat, the meat tray components?

MR SAMUEL: Well, separate the meat tray component or else look at the supermarket trade component generally.

MR CARTER: Does the supermarket publish a separate meat account?

5

MR SAMUEL: I'm just wondering whether you've done that in the analysis.

MR ECONOMOU: No, I don't think they'd be able to do it.

10 MR CARTER: I don't believe Coles have published the meat tray account, have they?

MR SAMUEL: Has your industry looked at the issue of collective bargaining in terms of producers dealing with, you know, the major processors and abattoirs and the like?

15

MR CARTER: There are some grand names, producers that have banded together by an agent to try and give a continuity of supply, but they haven't got a good record. One of the problems with the beef industry is that the producers are very individualistic. It's very hard to get them to band together because you've only got to get somebody come along and offer you another 5 cents and you've lost some of your team that were all lined up to sell somebody else.

20

MR SAMUEL: But doesn't the dollar motive, that is of more effective bargaining, tend to hold people together as part of collective bargaining process?

25

MR CARTER: Until somebody else comes along, yes.

MR ECONOMOU: There's a problem with that. The relative size of producers to processors and the relative size of processors to supermarkets is just out of proportion.

30

MR SAMUEL: Collective bargain is designed to actually overcome those relative size difficulties, and to actually level out the playing field.

35

MR ECONOMOU: Yeah, no I appreciate that, but still to get a critical mass where you've got bargaining powers, producers, you literally need the whole district producing one item and negotiating as a whole group to actually do something. The average plant kills a thousand cattle a day. I produce 300 cattle, I'm the biggest producers of within 100 kilometres of myself.

40

MR SAMUEL: So you need a group to act together in the way that, for example, chicken growers have done it or egg producers or dairy farmers have done it?

MR ECONOMOU: But you'd need a group like the whole of.....Victoria bargaining as a group just to deal with one abattoir and say "Yarrawonga".

45

MR SAMUEL: In much the same way the chicken growers and egg producers and dairy farmers have done it? I'm just wondering why the beef producers have not done it.

5 MR ECONOMOU: 1500/200 coordinate it to get to that critical mass. The structure of the industry is just that the relative sizes of the units of deduction are just so disproportionate.

10 MR CARTER: The only lot that are getting together is something like certified Angus beef or something, that's being pushed by Elders, but you've got to have the feedlot involved to keep the continuity supplied, and now that grain passes have gone haywire, this has become extraordinarily difficult.

15 MR SAMUEL: Why did the dairy farmers see it as to their advantage to get together and collectively bargain but beef farmers don't?

20 MR CARTER: It's this individuality. I mean I suggest that what I believe at least 200,000 people selling cattle in Australia or producing cattle every year well over 50% were doing it for a hobby. That's the difference between the chicken industry, the pig industry and the dairy industry. There's very few people doing it just for the fun of it.

25 MR ECONOMOU: On that point, though, the 50% that Mr Carter refers to probably only produced 5% of the cattle, but in a market of perishable goods, which cattle are, a small oversupply has a big impact on price and there's certainly a lot of very good data in America that points how sensitive their markets are to very small adjustments in supply.

30 MR SAMUEL: Thank you.

MR O'DONOVAN: Just on the demand for beef, the table beef, is that flat, going up, going down?

35 MR CARTER: Well, I would suggest it's fairly flat. The MLA never talks about the actual increase in consumption; they talk about the increase in money paid for beef, and there's quite a difference.

MR O'DONOVAN: I thought you were a bit sceptical of their data anyway.

40 MR CARTER: Extremely.

45 MR ECONOMOU: Certainly the.....figure, the per capita consumption, which is about 35.5 kilos haven't moved 5% up or down in the last 20 years, so it's been basically constant.

MR SAMUEL: All right, thank you very much.

Now Mr O'Donovan, we have two further witnesses. Natural Farmers Federation and South Sydney. I want to just check logistics. So first of all the availability of the room. All right, that's all right, and the availability of – you're happy.

5 We have gone over time, there's been a lot of valuable information that's come forward today, we'll talk to the Natural Farmers Federation about the source of the witnesses, the location, and it may be that we will travel there. We will try and work out some logistics to make it a bit easier for you. So I apologise for that. We will communicate with the NFF about arranging an appropriate time and place because
10 your information is going to be very important to us in terms of focussing on the grower industry in general.

All right, Mr O'Donovan, are you then ready for South Sydney?

15 MR O'DONOVAN: Yes.

Could you just state for the record your name?

MR KELLY: Yes, my name's Craig Kelly, and I'm the President of the Southern
20 Sydney Retailers Association.

MR O'DONOVAN: Okay, now you understand that it's a criminal offence to mislead the commission at this hearing?

25 MR KELLY: Yes, I do.

MR O'DONOVAN: Now can you just indicate to us what the Southern Sydney Retailers Association is?

30 MR KELLY: Before I start, could I have the opportunity of making a brief opening statement?

MR O'DONOVAN: Yes, certainly.

35 MR KELLY: Thank you. I welcome the opportunity to assist the ACCC in this inquiry and to find out what's gone wrong with the retail market in Australia. I'd like to congratulate Mr Samuels for the comments that he's made pointing out the contradictory nature of many of the submissions made to this inquiry.

40 Quite simply, the claims by Woolworths and Coles and their various camp followers that Australian consumers are benefiting from vigorous competition from the current market structure is one of the longest running and most effective disinformation campaigns in this nation's history.

45 I believe the evidence is overwhelming and it's irrefutable. The hyper-concentration in the retail sector which has been allowed to evolve under the settings of the Trade Practices Act have been detrimental to consumers and have undermined Australia's

economic prosperity. As Minister Bowen stated, when you compare Australia's performance on grocery prices with other countries, a disturbing picture begins to emerge. The minister also stated the fact that Australia has had the highest food inflation in the world is cause for concern.

5

Now if we look at the OEC data since 1990, supermarket prices in Australia have risen faster than anywhere else in the developed world, and not only just faster, but they've risen twice as fast as the average of developed countries. When you drill down, the numbers are even more appalling.

10

Since 1990 the CPI's increased just of 60%. The price of bread has skyrocketed 123%, milk 113%, eggs 102, snacks and confectionary 102, jams and sandwich breads, 96. These are all facts.

15 Yet if we look at milk, the farm gate price has actually gone back since 1990, but the retail price has increased 113%. As Mr Samuels has correctly stated, these are inconvenient truths for Woolworths and Coles.

20 On my calculations for milk alone, consumers are being price.....at least \$800m annually every year, but despite all these facts, there are still individuals who remain in a state of denial, refusing to admit that what we can all see, the concentration in the retail markets has raised prices.

25 Now we've had that nonsense debate during this inquiry about what Woolworths and Coles market share, whether it's actually 50% or 80%, how it should be measured. I say if you're being strangled by a boa constrictor it doesn't matter whether it's six metres long or eight metres long.

30 In the year 2000 the UK Competition Commission held an inquiry that found that an 8% market share was enough to distort competition and act against the public interests. Even the Wal-Mart CEO, which is the world's biggest retailer, Mr Lee Scott has said that once.....there's a 30% market share, that's the time when Government should intervene.

35 Now we see the Woolworths and Coles flying the flag of free competition, but if you look at what they practice and not what they preach, they're actually seeking special legislative Government privilege and protection and corporate welfare through zoning laws to fence off the competition.

40 A free market can only work where all firms pay the true and fair resources that they use, but when Woolworths and Coles have such market share, they're able to exploit their market power where they no longer pay the true economic cost of the resources they use, and this is especially evident in retail leasing.

45 But it's not only just the consumer that's losing. It's also the producer. We have seen producer prices in Australia rising a lot less than they have in the rest of the world.

Now if we look at, again, comparing our figures with OECD figures, basically Australia's performance has been appalling as far as competition is concerned. If we use the analogy of a football team, if a football team was doing so poorly they would sack the coach and they would clean out the management and the committee and
5 bring new people in, and they would have to admit that the policies and practices and game plans that they had, had failed and were completely wrong.

Now there's only a few possible reasons as why food prices in Australia have risen faster than the rest of the developed world. One could be currency movements, but if
10 we look since 1990, the value of the Australian dollar has increased, not only against the US dollar, but also against the trade weighed index. Changes in taxes are also possible. In the year 2001 we had the removal of sales tax on all business inputs on fresh food and packaging, which was recognised by everyone should reduce the price of food.

15 If we look at had there been greater farm gate price increases in Australia, and the evidence is no. Have there been greater cost increases, labour costs or energy costs? Again if we look at OECD figures, the answer is no. The only thing that has been different in Australia has been the concentration that has evolved in the retail market.

20 I look forward if I can answer any questions on any submissions that we've made.

MR O'DONOVAN: Sure. Now can you just tell us what the southern Sydney Retailers Association is?

25 MR KELLY: Certainly. We're a small retailers association, we formed just over 12 months ago. We felt some of the existing retail associations weren't arguing aggressively enough the changes to the Trade Practices Act.

30 MR O'DONOVAN: Sure, and can you tell us who its members are? Firstly, how many members does it have?

MR KELLY: We've got approximately 50 members. They vary from retailers and we also have some wholesalers, also independent people that are consultants in the
35 industry as well.

MR O'DONOVAN: Okay. Of those 50 how many would be participants in the grocery industry?

40 MR KELLY: Maybe a dozen directly, but other people indirectly.

MR O'DONOVAN: Okay. Let's just take the dozen direct, can you tell us, just indicate in which part of the industry they participate?

45 MR KELLY: Fresh fruit and vegetables and also meat.

MR O'DONOVAN: So are they independent fruit and vegetable shops?

MR KELLY: Independent people, yes.

MR O'DONOVAN: Independent.....?

5

MR KELLY: Yes.

MR O'DONOVAN: You yourself, do you participate in the grocery industry?

10 MR KELLY: Not directly, no. My business is involved in homewares and home furnishings. It's been involved in retail and wholesale. My basic businesses involved in exporting. Personally most of my work is done with customers in America in the Middle East.

15 MR O'DONOVAN: Right, so personally you have no actual dealings within the grocery.....?

MR KELLY: No, I have no relationship with Woolworths, I have no relationship with Coles.

20

MR O'DONOVAN: And no direct information from experience from working within the grocery industry?

25 MR KELLY: Not directly in the grocery industry, but the retail industry I believe I've had extensive experience.

MR O'DONOVAN: Sure. So in terms of the contribution of the debate, on grocery pricing, just from what you've told us and from reading your submissions, it would appear that what you offer is just an interpretation of the public data that's available.

30

MR KELLY: That's correct, yes.

MR O'DONOVAN: So you get information from ABS or the OECD?

35 MR KELLY: Yes.

MR O'DONOVAN: And then you offer a particular interpretation in relation to it?

MR KELLY: Correct.

40

MR O'DONOVAN: And in terms of having any special direct knowledge or insight into the actual operations of those markets, you're not telling us anything from personal experience?

45 MR KELLY: I believe I can – well no, yes I do believe I have a lot of experience in the retail sector itself, but not directly in the grocery sector, and that retail experience gives me reason to comment informatively on the grocery sector.

MR O'DONOVAN: Sure, okay, but just to confirm, but the primary source of your information is just publicly available?

5 MR KELLY: Yes, correct. We've also done other independent studies as well, which we put together in some other submissions, but basically we believe if we're looking at the city, we must look at published figures from the ABS because rather than come up with some of our own study which was really not relevant compared to the ABS figures.

10 MR O'DONOVAN: But at this stage you haven't submitted any of those privately done studies?

15 MR KELLY: No, we haven't, no, but basically the weight of the evidence, our own private study would be given way to one, whereas the ABS figures should be given the weight of a hundred or a thousand.

MR O'DONOVAN: Okay. If I can just broadly summarise your submissions, your basic theory is that competition has collapsed –

20 MR KELLY: Yes.

MR O'DONOVAN: In the retail grocery sector, and the reason is because of Coles and Woollies domination?

25 MR KELLY: Market concentration.

MR O'DONOVAN: So hyper-concentration, would you call it that?

30 MR KELLY: Yes.

MR O'DONOVAN: And the proof is the high retail inflation of both general and of particular commodities--

35 MR KELLY: Yes, if we look at the numbers specifically, if we look at the OECD figures, and then if we drill down to those figures into individual items, and then if we make comparisons with the increases in those items at the retail level and also at the farm gate level, and then also if we make international comparisons with them as well, all the evidence indicates that competition has collapsed at the retail level.

40 MR O'DONOVAN: Do you have a view about when this occurred?

45 MR KELLY: Yep. It's funny, if you look at the numbers, I believe it was the NAGA study published some information that showed the level of concentration of Woolworths and Coles, their growing level, and I think if you look at the numbers in about 1987 they actually hit over 50% on the NAGA numbers. Now if you run the figures, if you run those figures through, if you look at pre-1987, our food inflation

was actually less than the CPI. If we look at the numbers after 1987 when this concentration occurred, the numbers have gone the other way.

5 MR O'DONOVAN: Right, so 1987 is for you the year that retail competition collapsed?

MR KELLY: No, it's not just a collapse, something that happens overnight. This is a general process that has happened over 20 years.

10 MR O'DONOVAN: Sure, okay. Well then looking at your submissions it seems a lot of the figures you picked were from ABS table 6401?

MR KELLY: Look, there were many different ABS tables that I used.

15 MR O'DONOVAN: Sure, but do you recall –

MR KELLY: Which one are you specifically referring to?

20 MR O'DONOVAN: It's the one that gives the CPI by selected food items.

MR KELLY: Yes.

25 MR O'DONOVAN: Okay and you relied on that in relation to bread, eggs, milk and beef to show that –

MR KELLY: Yes, yes.

30 MR O'DONOVAN: Now can you tell us why you picked those commodities in particular?

35 MR KELLY: Firstly I picked milk because that was an easy commodity to look at the farm gate prices. Information was readily available that we could give a comparison of farm gate price against retail price. Also milk was a commodity that a lot of international comparisons are available with.

Bread, we picked bread because that is a commodity that has arisen substantially in price. That's an item that's been in the media and there's basically been a lot of reports in the media saying that the price of bread is rising because of the drought.

40 If you look at eggs, we picked eggs because, again, that's a very simple production process. As you said, there's no great processing, like the chicken lays an egg, it's watched and put in a box and goes to – puts it on the supermarket shelf. There's no freight complicated publication chain of processing that's involved.

45 MR O'DONOVAN: Sure.

MR KELLY: We could have also picked other items. Like one particular item in example was fresh fruit and vegetables. Sorry, fresh fish and other seafoods. I think if you're looking at anecdotally, I think if you look at which food sector is least concentrated, which does the independence have the greater share, and the
5 supermarkets have the lesser share on it, and I think on that you would pick fish and seafood, and yet that is one of the items that has arisen less than all of the rest of the items for food.

MR O'DONOVAN: Sure, but if you were to pick another item, for example,
10 breakfast cereal which you agree is an area in which the supermarkets do have a high level of concentration; you'd agree with that?

MR KELLY: Yes.

15 MR O'DONOVAN: And if you had picked that, you'd find that breakfast cereal has gone up significantly less than the rate of the CPI in the period.....

MR KELLY: Of course, yes. There is a remarkable fluctuation across the items. For example, poultry as you see has basically had no increase since 1990 and yet
20 eggs have gone up 100% which seems to be – there seems to be something crazy there, something that doesn't obviously work.

Just to confirm, the price of poultry fell in real terms in the last, and that's the retail price of poultry.
25

MR KELLY: Actually, I think it's an increase of 3%.

MR O'DONOVAN: Sure, but in real terms. In real terms.

30 MR KELLY: Yeah, if we're looking at the ABS index, the increase, I think the price of poultry had actually fallen. Now I'm not sure how the ABS put together their index for poultry, whether that involves a lot of the fresh barbeque chickens that are sold in a lot of thousand and thousand of independent stores throughout Australia. I'm not sure how that number is put together. That is something that would need
35 further research.

Obviously it seems very unusual that poultry, there'd be no increase, and yet eggs would have like over a thousand per cent increase.

40 MR O'DONOVAN: Sure, and the fact that it isn't completely inconsistent with your theory of the collapse in retail--

MR KELLY: No, I disagree totally. I think if you looked at, perhaps, poultry, I think that is perhaps one item, if that includes figures for fresh barbeque chickens in
45 the poultry price, that is an article where thousands of independents in retail shop fronts have still been able to maintain rather than just being controlled by the

supermarkets. Therefore I will suggest that the fact that the poultry has had a small increase actually supports my proposition.

5 MR O'DONOVAN: Well, let's take breakfast cereal then, which doesn't exhibit any of those factors and has risen less than the CPI.

MR KELLY: Yes.

10 MR O'DONOVAN: That would be inconsistent of your theory?

MR KELLY: Of one example, against probably with ten examples the other way and the one the other way, probably, yes.

15 MR O'DONOVAN: Well, if you're putting chicken as well, just working off the ABS table without theorising further, again that's on it's face –

20 MR KELLY: There is a great discrepancy cease in the numbers of the – if we break each individual food items down, as you say there has been a freight discrepancy in the numbers.

MR O'DONOVAN: Sure, but these are the numbers which you rely on?

25 MR KELLY: Correct, yes, and if we look at overall, if we take the numbers overall, it's undeniable that the food has increased faster than the CPI.

MR O'DONOVAN: Sure.

30 MR KELLY: And what was also of concern, if we look at that against OECD figures, there's only one country in the developed world that that's happened and that is Australia. If you also at which is the most concentrated market in the world, you also come up with that is also Australia.

35 MR O'DONOVAN: Sure, in terms, as I understood your theory, in relation to milk and bread and eggs, the argument was that those commodities demonstrate the rising price in those quantities, demonstrated a collapse in retail competition.

MR KELLY: Correct, yes.

40 MR O'DONOVAN: But that collapse is not in evidence in many other commodities like pork and ham, seafood, poultry, breakfast cereals -

45 MR KELLY: As we said, we said I think one of the earlier gentlemen that was here today, he said that he buys all these deli products direct from the supplier. He doesn't need to go through a wholesaler. Perhaps that is the reason why pork and ham has increased less. I believe without being an expert in park and ham, I understand there's been a lot of imports out of Canada which have helped lower the

price, so there's different factors in the supply chain, different cost factors in each commodity which would need to be looked at.

5 MR O'DONOVAN: Sure, but if collapse in retail competition was present, you would expect that the retailers would increase their margins on all products.

MR KELLY: Not necessarily, no. No, not necessarily.

10 MR O'DONOVAN: Not necessarily?

MR KELLY: No. Some items would obviously increase more than others. I think to suggest that all retail items would increase at the same amount I think would be an incorrect assumption.

15 MR O'DONOVAN: If the reason is, as I understand the reason you say prices are increasing at the rate they're increasing is because of a collapse of competition.

MR KELLY: Yes.

20 MR O'DONOVAN: There's no discipline. If that were the reason for the prices of commodities to go up or down, wouldn't that reason be reflected equally in all the products?

25 MR KELLY: No, I don't think so. I think there'd be – each item has different cost factors. We don't know whether the price of breakfast cereals has decreased substantially. I have read an article from America which basically said in the 80s that they said the price of breakfast cereals was grossly inflated and has come down substantially since.

30 You also would need to look at what base each of the figures have come off. There could easily be a large increase or a big decrease before. That's why it's very important to look at these figures over a long period of time rather than just a short period of time.

35 MR O'DONOVAN: Sure, so is it fair to say that you can't just look at one piece of data and then make a general conclusion about it?

40 MR KELLY: Correct, and that's – that is why we looked at the OECD figures as a comparison, a country comparison, that's why we've looked at not only the total figures, we've compared it against the CPI, then we've looked at individual products, individual commodities with inflation within this commodity, and we've also then looked at individual items as well. So I think we give a complete and detailed picture.

45 MR O'DONOVAN: But when you've chosen commodities, you've only chosen commodities where the data, where you already knew that the data showed that the prices were increasing about the CPI.

MR KELLY: Well that's correct because they are increasing above the CPI.

5 MR O'DONOVAN: But there are many others that are not, and you've given them no attention at all.

MR KELLY: No, okay. As I said, I said obviously why has fish and other seafood increased less in price than milk? Is it because in fish and other seafood is an area of our retailing sector that is not as concentrated?

10 MR O'DONOVAN: Do you have any specific data about that?

MR KELLY: No, that's why I hoped that would be something that the ACCC would further investigate to find out what the concentration is in that market sector for fish and seafood and perhaps that is the reason why those prices have not increased as fast as milk and other products.

MR O'DONOVAN: Sure, but at this point in time you're only speculating.

20 MR KELLY: Well, based on all the evidence, I believe it's a very accurate speculation.

MR O'DONOVAN: The evidence about concentration in the seafood.

25 MR KELLY: No, sorry, are you talking overall or are you speaking specifically? You're talking specifically on seafood?

That your speculation that the reason why seafood has not increased above CPI as opposed to milk, which is that there's less concentration –

30 MR KELLY: Yes, as I said before, I haven't any figures on the concentration of the market for seafood. I don't know if those figures are available. I think to make any accurate comparison, you would also need to look at what the costs have happened in seafood, the producer price costs, or I don't know whether you call it the farm gate costs is obviously not the correct expression, whether it's the trawler costs or something of seafood. Obviously those factors have to be taken into consideration as well.

40 MR O'DONOVAN: Sure.

MR KELLY: Now we know those figures are not readily available like they are for milk. Now for milk that we can see that the farm gate price is actually lower today than it was in 1990. We can see, for eggs, we can see the farm gate price is basically oscillated and there's very little difference between today and 1990.

45 MR O'DONOVAN: Sure, but it's not a simple matter in relation to any one of those data points to work out what it really means, is it?

MR KELLY: Well I think it is a simple matter. You can look at what the retail price increase has been, you can look at what the farm gate price increase has been, and if there was subsequent difference, and here we are talking huge differences between that and the CPI. Surely anyone can see that there is a significant problem. We're
5 not talking like, if we take milk for example, milk has risen 53% higher than what the CPI has since 1990, and yet the farm gate price has gone backwards. I would suggest that is a significant amount and a major concern for this inquiry.

MR O'DONOVAN: Sure. Now if – I'm not suggesting that's not a major concern; what I'm suggesting is how accurately you've identified the source of the problem.
10 Now you say, as I understand it, you're saying it's exclusively the source of the problem is the concentration of the major supermarkets.

MR KELLY: It's the factors behind it that cause the concentration of the major
15 supermarkets. There's also a significant problem with zoning laws in this country that has handed the shopping centres a virtual monopoly and enabled them to increase rents, again well above CPI. If we look at the figures on rents in original shopping centre in Australia, for food retailers they're paying 1500 a square metre. That's the average rent that's being paid in a regional shopping centre in Australia.
20 In the USA –

MR O'DONOVAN: Sorry, can I just stop you there?

MR KELLY: Yeah.
25

MR O'DONOVAN: Can you just identify the source of that information?

MR KELLY: Certainly, the source is I think it's Urbist IJDH figures that show the
30 1500 a square metre. In the USA the figures are from – the source is called The Dollar and Cents of Shopping Centre, which is a book published by the urban land institute which publishes all the occupancy cost and retail rents and shopping centres throughout the USA. The rents in the USA are around about 40 US dollars on average. If we look at the percentage or occupancy costs for food retailers in the USA, their occupancy costs are less than 5%. According to those Urbist JDH
35 figures, the occupancy costs here around 13%. So the collapse of competition is not only by the retailers themselves, it's also been a collapse in the market for retail leases.

MR O'DONOVAN: So are you suggesting that that's a problem?
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MR KELLY: Definitely. The zoning laws in this country are one of the reasons that have helped created the concentration of the market and it's also one of the reasons why our food inflation is rising faster than the rest of the developed world.

MR O'DONOVAN: I'm not sure that I actually follow the relationship between
45 market concentration and the cost of retail space.

MR KELLY: Okay, every retail shopping centre that is built is anchored with a Coles or a Woolworths centre or either a target or a Kmart, which is part of the Coles group, or a Big W which is part of the Woolworths group, okay. That space is leased to them at less than 20 a square metre. Now the source of that is at least information services. I can give you detail and give you the data on that.

For an independent retailer, he's paying up to 1500 or more per square metre, so the independent is actually paying up to ten times more rent than the supermarkets are for their retail space. Now what that has done, that has basically the supermarkets to occupy space in shopping centres at below the economic cost of supply. That has basically insulated them from competition.

The other gentleman that we had here earlier today, when they operated a supermarket, they have to pay the full costs of the space they occupy. Now these zoning laws are given Coles and Woolworths artificial strength and artificial power, right. That would not be able to happen if the zoning laws were open.

MR O'DONOVAN: When you say "the zoning laws"-

MR KELLY: Yes.

MR O'DONOVAN: What aspect of the zoning laws do you say delivers this power?

MR KELLY: For example, an area close to where we are, there's a shopping centre next to Warwick Farm Racecourse, okay. A few years ago Clint's Warehouse there put food in and they put other products that were competing with Woolworths. Woolworths then took them to the Land and Environment Court and had them basically closed down. They were denied the right to sell food from a shop. This is how the zoning laws worked. They denied -

MR O'DONOVAN: If I can just stop you there. That does not appear to have any relationship at all to the rents being charged in the shopping centre.

MR KELLY: Yes, it does, because what happens the shopping centre that establishes basically creates a monopoly. If I want to go and sell food across the road, if the shopping centre establishes in a certain area and I - and they ask me for \$1500 a square metre and I said "That's ridiculous, I'm going to go and lease the shop across the road, I'm going to set up my own shop across the road". If I buy land and I build my own premises, I shouldn't have to pay about \$300-\$400 a square metre. The zoning laws prohibit me from doing that. Therefore the shopping centres are given the monopoly, they can basically price gauge small and independent retailers into these paying these huge rents because they have nowhere else to locate their businesses.

MR O'DONOVAN: So the zoning decisions of councils, are you saying?

MR KELLY: Yes.

MR O'DONOVAN: Are the source of the problem?

MR KELLY: No, I'm saying that is one of the sources of the problem.

5 MR O'DONOVAN: All right. Now you'd be aware that in terms of numbers of supermarkets, there's two and a half of thousand independent supermarkets in Australia.

MR KELLY: Yes, I've seen those approximate numbers, yes.

10

MR O'DONOVAN: Okay. So there are significantly more independent supermarkets than there are Coles and Woolworths?

MR KELLY: I saw, I think, in the Woolworths submission that they put in the numbers of retail shops or something that had actually occurred. Now you can't compare, and they said they did some comparison on numbers, they said, I think, without looking at the thing, we've opened ten supermarkets and there's been like 20 independent retailers open, therefore there's more independent retailers opening. Such interpretation is completely incorrect. You must look at these –

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MR O'DONOVAN: Sorry, I just stop you there. The question I was going to ask was if as you say retail competition has collapsed and that – and I think that you used the expression that the major supermarkets are free to increase profits almost at will, why is it that customers are not leaving them and going to the independent supermarkets?

25

MR KELLY: Well I think the independent supermarkets are suffering from price discrimination where they cannot obtain their business inputs at a competitive price.

30 MR O'DONOVAN: But you have no specific knowledge of any of that?

MR KELLY: For example, a two litre bottle of Coke –

MR O'DONOVAN: No, sorry. The question I've asked you is do you have any specific knowledge?

35

MR KELLY: Yes, and I was giving you the example of a two litre bottle of Coke, right? The people that I speak to have said that the wholesale for the independents of a two litre bottle of Coke is around about \$2.60-\$2.70. They estimate Woolworths, who often discount it down to around about \$2.10, are paying around \$1.80 for it. So they believe they're paying sort of like 30/40/50 even 60% higher than Woolworths and Coles are actually paying for it, and many times they find that they – the price that the wholesaler was charging them is higher than what Woolworths are retailing the product for. I've often seen the local IGA person in the Woolworths Supermarket even with their IGA uniform on with a shopping trolley filling up at Woolworths because they obviously can't buy the prices – they obviously are paying a higher price than what they are from Metcash are charging them.

45

MR O'DONOVAN: Sure, which suggests that Coles and Woolworths are providing consumers with a product at a good price.

MR KELLY: No.

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MR O'DONOVAN: Or at a better price that is available at the independents.

MR KELLY: Again, if I could use the example for Coke, I put in one submission in that, Woolworths price, I think, was around about the \$3 mark. We did some
10 comparisons with Safeway Supermarkets in the USA and their price is around \$1 US. Now if we do the comparisons and make allowances so we're actually making an apples for apples comparison and we're using exchange rates and taking off the GST, the price that Woolworths is charging is 100-15 0% higher for a bottle of Coke.

15 MR O'DONOVAN: Sure.

MR KELLY: So I don't think there's any way that you can say that Woolworths are offering consumers low prices.

20 MR O'DONOVAN: But you don't know anything about the wholesale price at which it was purchased by either Safeway in America or Woolworths in Australia, do you?

MR KELLY: I know that in the Safeway Supermarket we looked at was in
25 California and in California they have a below cost sales law where they're not allowed to price items below cost. I can give you the relevant section if you would like. So therefore one could assume that the wholesale price would have to be less than a dollar in the USA. Now we don't know what the wholesale price is here that Coles are paying for Coke. Maybe that's something that this inquiry could look at.

30

MR O'DONOVAN: Sure, but in terms of working out whether or not what we're seeing there is a problem at the wholesale supplier level or the retail level, you have no ability to tell us about.....

35 MR KELLY: Well, I looked at – I thought perhaps why would a bottle of Coke be 150% higher in Australia than it is in the USA? I thought well, perhaps, one reason would be larger economies of scale in America. Now I thought that is a possibility. Now if that would apply, the same situation would occur in New Zealand.

40 Now Woolworths have recently taken over, I think it's Progressive Supermarkets in the USA. I just out of interest had a look at the price, what Woolworths was charging for a two litre bottle of Coke in New Zealand. Now their regular price was \$2.60 in New Zealand and they had it on sale for \$1.95 New Zealand – sorry, yeah \$1.95 New Zealand. Now again, if we make allowances for exchange rates and
45 GST, and this was also a larger bottle of 2.25 litre, Woolworths were selling that in their New Zealand supermarkets at the equivalent of \$1.40. In Australia at the same time the retail price was \$3.15.

MR O'DONOVAN: Now did you choose that product because you knew that it would produce those sorts of results?

MR KELLY: I had a friend –

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MR O'DONOVAN: No, no, just answer that question.

MR KELLY: Did I choose that product? Of course, yes, I had a friend come out from America and he said "I can't believe the price you Australians pay for Coke". He said "\$2 or \$3 a litre this is ridiculous". He said "I can get it from half a dozen supermarkets at \$1 for a two litre bottle any time I want".

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MR O'DONOVAN: Sure.

MR KELLY: And I said "Look, surely this can't be true". He said "I'll send you out some flyers". So he's posted me out some flyers, you know, and this is just amazing.

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MR O'DONOVAN: So you did the analysis knowing what the result was going to be on that particular product?

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MR KELLY: No, I was informed that that was an item that had significant – had a significant problem with it. It was not a matter of picking the – it was an item that stood out. Yes, someone had informed me that said yes, this is an item, there's a huge overcharge on, and I thought that was very important information that this inquiry should be informed of because when we hear that Woolworths and Coles, you know, where the most competitive retail market in the world and they're lower in prices, if you can buy something as common as a 2 litre bottle of Coke for half the price in supermarkets in the USA, something is seriously wrong.

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MR O'DONOVAN: Now if the problem is at the retail level, why is it that the IGA shop, people who work at IGA are shopping at Woolworths to get their product? If there is a big gauge at the retail level, surely IGA would be able to undercut Woolworths.

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MR KELLY: You'd have to look at what prices IGA are able to get it from, from their wholesaler, through Metcash.

35

MR O'DONOVAN: Sure, which suggests that the problem mightn't be at the retail level, but it might be at some other level of the supply chain, if there is be problem at all.

40

MR KELLY: I'm sorry, I'm not with you on that.

MR O'DONOVAN: Well, if as you say there's a big gauge happening from Coles and Woolworths, you would expect that a competing retailer willing to accept a smaller margin could sell Coke at a lower price.

45

MR KELLY: Well it depends if you can obtain it at a fair market price or not.

MR O'DONOVAN: All right, and if a retailer can't get it at that lower price, that suggests that the problem is not happening at the retail level, but is at the wholesale supply level.

MR KELLY: Well, you're overlooking price discrimination. It could very well be that Woolworths and Coles use their market power to screw such a low price out of the wholesaler for Coke, out of Coca-Cola, that to recoup that loss or to try and make up the margin that they've given away to Woolworths and Coles, they have to increase their prices to others.

MR O'DONOVAN: Sure, but that's a matter on which you have no particular visibility?

MR KELLY: No, and that's something, obviously, I hope this inquiry makes a clear study of, because as I said on the information that I have, which is only anecdotal information, that the wholesale price of Coke is significantly higher to independent retailers than it is to Coles and Woolworths.

MR O'DONOVAN: All right. Now in relation to – if I read your submission on bread correctly, you indicated that it has been on ABS figures anyway, going up by the CPI, and say that there's only two possible explanations. One is drought has pushed up the prices and then you analyse the cost of wheat as an input into bread, and then you say the only other possibility is that the competition has collapsed. Is that a fair summation of your bread submission?

MR KELLY: I think also when you have to also look at the price increase in Australia compared with the rest of the developed world, now in that I was able to obtain references from the Bureau of Labour Statistics in the USA and also the Office of National Statistics in the UK. Now they show that the price of bread, for example, in the UK between 1990 and 2007 have increased 60%, but in Australia it increased over 120%.

MR O'DONOVAN: Sure, but again that's just taking ABS data purely on face value.

MR KELLY: Yes. Look, if you'd like you can dismiss the ABS data, but that's the best data we have. They're professional statisticians. I've asked them "How do you, you know, how do you actually do this?" And they said "Look, it's a very rigorous analysis that we use and we're very confident that our data is correct".

MR O'DONOVAN: Sure. So you've rung them up?

MR KELLY: Yes.

MR O'DONOVAN: Now it has been suggested to the inquiry that one of the factors in the food price inflation is that the data doesn't adequately reflect the fact that as prices increase on a particular good, consumers move to another lower priced good. So, for example, if bananas went to \$29 a kilo, there was a huge jump in food price inflation, but it didn't –

MR KELLY: I'm glad you asked that question.

MR O'DONOVAN: I haven't asked the question yet.

MR KELLY: I'm sorry.

MR O'DONOVAN: So now you've understood that that submission has been put?

MR KELLY: Yes, that is, I think, what they call the Woolworths index.

MR O'DONOVAN: Sure.

MR KELLY: Like quite –

MR O'DONOVAN: I want to get to my question. Now is it possible in relation to bread, where there's been a fair bit of price competition introduced by ALDI and where generic breads have been introduced at very cheap prices by the major supermarkets, that that strong shift away from random products, which have remained at relatively high prices, to generics which are at much lower prices, isn't being picked up in the CPI data that the ABS is producing. That's a possibility, isn't it?

MR KELLY: Firstly going back to your analysis with the bananas, I believe Woolworths if their submission put something the Woolworths index which suggested that inflation measurements of inflation –

MR O'DONOVAN: Before we go to that, can you answer my question?

MR KELLY: Can I answer the one before or not? Can I answer that later?

MR O'DONOVAN: All right, you go.

MR KELLY: No, which question would you like me to answer?

MR O'DONOVAN: Is it a possibility that the ABS data is simply not reflecting the way in which customers are shifting to generics?

MR KELLY: So you're saying does the ABS have it all wrong; is that your question?

MR O'DONOVAN: No, no, I'm asking whether you would accept that it's a possibility.

MR KELLY: That the ABS has it wrong?

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MR O'DONOVAN: That the ABS data doesn't reflect the price competition in things like generics.

MR KELLY: I've actually – that's what I asked of –

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MR O'DONOVAN: So, for example, for bread.

MR KELLY: Well that is what I asked of the ABS and they said ours takes into all considerations about what's expenditure and the different types of – I asked that question on milk and they said it takes across all different types of milk and generics, so I think that to suggest the ABS has had had wrong is – no.

15

MR O'DONOVAN: It's not a possibility?

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MR KELLY: That the ABS have it wrong?

MR O'DONOVAN: Well just have – I'm not saying the data doesn't accurately reflect the weightings.

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MR KELLY: Well, it's wrong. You're saying that the ABS data is wrong.

MR O'DONOVAN: I'm saying that it doesn't reflect the way in which consumers are switching to the more price competitive products. So, yes, that it doesn't –

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MR KELLY: So you're saying that the ABS data's wrong.

MR O'DONOVAN: That it doesn't reflect the extent of price competition entirely.

MR KELLY: I say that the fact that the possibility of the ABS data is wrong is a very, very, very remote possibility, and I think that is something you perhaps might want to question the Australian Bureau of Statistics on and say "Hey guys, is it possible you've got it all wrong?". Because I think the Reserve Bank might be very interested in that because perhaps they're raising interest rates unnecessarily if the ABS has it all wrong.

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MR O'DONOVAN: Now you wanted to make a comment on bananas?

MR KELLY: Yes, on the – I think it was called the wool worth index of inflation where they suggested that the – or they implied that the ABS had had it wrong, where they suggested it shouldn't be a price measurement, it should be an expenditure measurement. I suggest that is just a crazy suggestion. What that would actually involve, if we took, say, just one quick example of meat prices, so if

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sausages were \$5 a kilo and steak was \$30 a kilo, if we had a hundred per cent inflation, sausages would go to 10 and steak would go to \$60 a kilo. Now I think everyone would agree that would be a hundred per cent inflation.

5 But if you use the Woolworths index where they suggest it should be expenditure based, if many people said “I can’t afford to buy steak at \$60”, and they swung in to support sausages as well, that would show that inflation didn’t exist. That is why the inflation, to measure inflation you must use the price measurement rather than the expenditure measurement which is what the ABS do.

10 MR O’DONOVAN: Now in relation to, take for instance the product like eggs which you’ve said have increased above the rate of CPI over the period.

MR KELLY: Yes.

15 MR O’DONOVAN: Now there were periods within that time when eggs did not increase above the CPI, so for example between 1997 and 2002, the price of eggs did not increase above CPI. Now would you agree that that’s inconsistent with your theory of collapse of retail price competition?

20 MR KELLY: No. I think if you look at the farm gate price of eggs, I think they’ve oscillated greatly. I believe there’s a submission there in the – from I think it’s the Egg Board, Egg Bureau, that put together a submission, and they have actually had a little chart which shows the farm gate price of eggs and it has jumped up and down significantly. So you would need to look at during that period if the farm gate price actually fell as to make any accurate comparison or any comment.

25 MR O’DONOVAN: Sure, but if – if as you say there’s no competition at the retail level, wouldn’t the wholesale level price be irrelevant, that supermarkets would simply keep adding margin to the product?

30 MR KELLY: That’s why it’s very important to look at these figures over a long period of time. To look at any because food prices do fluctuate, because they are often commodity-based prices, we do have shortages of supply at times and we do have over supply at times where the prices jump up and down. To make any judgment over just two or three or four, even five years, I think is in danger of coming up with an erroneous result. That’s why I think if you’re looking at eggs, you must look over a long period of time which I suggest 1990 to 2007 gives us a good window and during that period we see the retail price has increased 102%, but the farm gate price has gone sideways.

35 MR O’DONOVAN: I suppose the question I’m putting to you is if that increase is the result of a monopoly, or monopoly behaviour by the two supermarkets, do you concede that those prices will consistently rise regardless of market conditions, wouldn’t it?

45 MR KELLY: Consistent. No, not at all.

MR O'DONOVAN: Well why would they lower them – just answer me this: why would they lower them? Why would they not increase them at above the CPI if they could?

5 MR KELLY: Well maybe there was a huge decrease in the costs and the costs that they lowered them by should have been much, much more than they actually did.

MR O'DONOVAN: Even still, why wouldn't they just take the bigger margin?

10 MR KELLY: That's what I'm saying, if you're looking at over a narrow period of time –

MR O'DONOVAN: We're talking five years. If there is this monopoly where they can price at will increased profits at will, why wouldn't they just keep increasing the price of eggs above the CPI throughout the period?

15 MR KELLY: Okay, well that's interesting. If you look at the numbers –

MR O'DONOVAN: No, no, just answer me that, why?

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MR KELLY: I'm sorry, I'm still not with you on the question.

MR O'DONOVAN: Why wouldn't they increase, keep increasing the price of eggs above the CPI, if as you say they can increase the profits at will?

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MR KELLY: Well that's in – the data I have seen they have increased the prices above the CPI, and that has occurred since –

MR O'DONOVAN: But why wouldn't they have done this consistently in every period?

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MR KELLY: Which you're saying every – they put up – so you're suggesting unless it's 2% than above the CPI every year, I think that's a crazy suggestion. I think you're going to have times, of course, where prices will fluctuate up and down here and there, but you need to look at the overall trend, and the overall trend is an unexplainable 102% increase which is over 40% higher than the CPI. Now that has occurred since 1990.

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Now if we go backwards, if we look at the data before 1987, right, before we had this concentration in the market, you will see that that has not occurred. You'll see generally that the prices of eggs and other products such as milk and food in general, has increased less than the CPI. This increasing above the CPI which is only happened in Australia – Australia is the only developed country in the world where this has happened, has only occurred since 1997 when Woolworths' and Coles' market share surged above 50%.

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MR SAMUEL: Mr O'Donovan, I'm going to call this to a halt because I think what we're getting into is a debate at the moment and I'm reminded that the I'll add more statistics of Dan Bligh's, and that's - sorry not to mean any disrespect to you, Mr Kelly, at all.

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MR KELLY: The figures that –

MR SAMUEL: Just let me finish, sorry, because there's a whole range of issues that have come up here that I think we are undertaking some very detailed examination concerning the ABS statistics, how they relate to what's happening in the marketplace. You know, statistics can be presented in one form and they can also be presented in another form to give you entirely different results.

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Just by way of a very quick example, it was drawn to our attention this afternoon by representatives of the egg producers that in their view the growth in retail price on a like for like basis of eggs over the period of time you've reflected on, where I think you've indicated the growth is 102%, their analysis is that the growth of retail pricing, they are produced by but not retailers, was 26%.

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MR KELLY: So you're saying the ABS was wrong?

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MR SAMUEL: Well, they're not saying the ABS because we didn't ask about the ABS.

MR KELLY: Well, if they're saying it's –

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MR SAMUEL: Sorry, just bear with me for a moment. They're not saying anything about the ABS. What they're saying is that on a like for like basis, that is comparing similar eggs to eggs today, and those produced in the early 1990s, that the growth in retail price was of the order of 26%, not 102%.

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So all that suggests is that statistics are capable of different forms of interpretation, which I think we all need to reflect upon and as you said on countless occasions through your evidence this afternoon, these are various matters that we have to examine.

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We have to examine what's happened in relation to milk, what's happened in relation to eggs, what's happened in relation to bread, what's happened in relation to cereals, and then what's happened in relation to Coca-Cola, I guess, but equally we also need to examine what the profitability of the various retailers are and so, of course, it won't be unexamined that we'll be looking at the gross and EBIT margins as published of the US retailers, the UK retailers and the Australian retailers because that may equally reflect some comparisons as to profitability and thus the extent to which a competition is effected.

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The reason why it is fundamentally important that we get this right is that if you take your proposition, which is that the problem in retail groceries, as you describe it, is

attributable to lack of competition and that that were to be taken at its face value and then lead to recommendations to Government, that can have some very, very serious and significant implications on the economy of Australia and on the grocery industry in Australia which may well be based upon false premises as to statistical
5 interpretation and analysis. That's, I think, something that the ACCC needs to address as part of this inquiry.

MR KELLY: Could I just make a couple of comments on that, you are correct, yes. We need to look at why has the price of milk increased 113%, the CPI's been 16%,
10 yet the farm gate prices have gone nowhere. Now if that is obviously a question that we need to answer in this inquiry.

Secondly, in relation –

15 MR SAMUEL: Can I just ask you a question on that: has the ABS taken into account the 111 cents per litre levy that was imposed as part of the deregulation restructure in 2000?

MR KELLY: Of course, they have, yes. They have. That is in those figures. You
20 also have to remember that –

MR SAMUEL: So that's part of the inflation factor that's – I mean if you take the retail factor, have they neutralised out the 11 cents levy?

25 MR KELLY: Of course. That 11 cents a litre is, of course, reflected in the ABS numbers. It's the same with the elimination of sales tax on all milk inputs and the packaging was also reflected in the number.

I'd just also like to comment on you mentioned about competition and profits and
30 making a comparison of America and Australia. There's an organisation called the food and marketing institute in the USA. They said their membership is made up of three-quarters of the total grocery market of the USA plus they have members in, I think, 100 international countries. They state as far as profit, they state the intense competition among food retailers for the consumer dollar is best demonstrated by
35 profit margins that continue to be less than 1.5% on each dollar of sales. For the fiscal year 2005/2006, the industry's after tax net profit was 1.46%.

Now if we look at that industry average in the USA, and we compare that with
40 Australia, we now have Woolworths, I think, at an EBIT of about 6 and Coles at an EBIT of about 4.

MR SAMUEL: Hold on, didn't you just give me a statistic for the US that was after tax?

45 MR KELLY: After tax, yes.

MR SAMUEL: Yeah, well, EBIT is before tax.

MR KELLY: Okay, let's take Woolworths after tax is probably around 4 and Coles is probably around about 3, right. Now we can look at those numbers. We can also – the Americans also published figures which included before tax as well, right, so there is data –

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MR SAMUEL: Anyway, Mr Kelly we'll be examining some of those. All I just suggest to you is that a very rigorous examination is needed of statistics and their presentation. We have some different numbers in relation to the United States, which I won't go into now, but let me just simply say that these are matters that we have to examine. It's very important that for the sake of the Australian economy, the Australian consumer and the structure of the grocery industry that we get this right rather than working on, you know, one person's analysis of statistics or, you know, sort of some basic propositions that are put to us that, you know, Mr O'Donovan is attempting just to analyse a bit in some of his questions today. So I can undertake to you we'll be actually examining those things very carefully indeed.

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MR KELLY: Okay, thank you.

MR SAMUEL: Thank you. All right I'll close this hearing, Mr O'Donovan, and we'll look forward to seeing you again tomorrow.

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MR O'DONOVAN: Thank you.

25 **ADJOURNED**

[6.24pm]