Public hearing – Melbourne

2 June 2008

ACCC Inquiry Members: Graeme Samuel; Stephen King; John Martin

Counsel assisting – Mr Damien O'Donovan and Ms Catherine Freeman

Time: 9.15am – 5.00pm

Address: **ACCC Office**
Level 35, The Tower
360 Elizabeth Street
Melbourne

Time (indicative only)	**Witness**	**Submission**	**Summons**
9.15am	Sunny Queen Farms **Mr John O'Hara** Chief Executive Officer	n/a	Summonsed and compelled to appear by the ACCC
10.00am	Metcash **Mr Andrew Reitzer** Chief Executive Officer – Metcash **Mr Greg Watson** Metcash General Counsel	No. 74 on website No. 181 (late submission on website) No. 217 (late submission on website)	No
1.00pm – 2.00pm	*Lunch*		
2.00pm – 5.00pm	Metcash (cont)		

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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: MELBOURNE CENTRAL TOWER, MELBOURNE

DATE: 9.24 AM, MONDAY, 2 JUNE 2008

THE CHAIRMAN: Thank you very much indeed for coming down, and I think we will open this hearing My name is Graeme Samuel, I am the chair of the Australian Competition and Consumer Commission; and chair of this public inquiry into the competitiveness of retail prices for standard groceries. I am joined by Commissioner John Martin and Commissioner Stephen King who are the other two presiding members for this inquiry which has been convened under part 7A of the Trade Practices Act pursuant to a request from Minister Chris Bowen, the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs. He made that request on 22 January 2008 and details regarding the inquiry are set out on the ACCCs website.

All witnesses will have received a document that outlines how we intend to approach these hearings so I won't go to the procedural points in detail. I just want to emphasise that although we are not taking evidence under oath at this hearing, it is a serious offence to give false or misleading evidence to the ACCC.

Now, in relation to confidentiality, if a witness believes that a particular question or series of questions are likely to result in a disclosure of confidential information, then the witness should indicate an objection to answering that question on that basis; and I will then consider whether the inquiry should take the evidence in private.   I note that although we are not using external counsel, the witnesses will be questioned by our internal lawyers – Mr Damien O'Donovan assisted by Ms Catherine Freeman. I thank Mr O'Hara for attending, and particularly coming down from Brisbane. Thank you very much indeed. And hand over to you, Mr O'Donovan.

MR D. O'DONOVAN: Could you please state your name, the company you represent, and your position within that company?

MR J. O'HARA: Sure. My name is John O'Hara. I'm the CEO of Sunny Queen Proprietary Limited.

MR O'DONOVAN: Okay, and can you just describe the business of Sunny Queen.

MR O'HARA: Sunny Queen is the – we're a marketing, sales and distribution business in the – selling eggs and egg products to the total marketplace.

MR O'DONOVAN: Okay, and are you vertically integrated, in that do you produce your own eggs or do you simply acquire from contract growers?

MR O'HARA: We do both. We actually – about 70 per cent of our business is our own farms, so we are a hundred per cent farmer owned. And we buy the other 30 per cent from the general marketplace.

MR O'DONOVAN: Okay. Now, how does the general marketplace operate? Is there a wholesale market for eggs?

MR O'HARA: Well, we actually buy from other farms, and then we on-sell to the wholesaling market and – well, you would call it wholesaling market, the – which would be the alternative market to supermarkets, the chain stores. So we sell right across the spectrum.

MR O'DONOVAN: Right, okay. But in terms of how you acquire from farmers, you simply ring them and offer them a price; or they ring you and offer a price?

MR O'HARA: Yes, normally we – with a lot of farmers we have a contract to supply where we have a low point and a high point in our contract and, depending on what price we can get out in the marketplace, we negotiate a price with those farmers. So there's no set time period that we would sit down and say, here's the price for six months. It's a case of, if market conditions change we go back and talk to the farmers.

MR O'DONOVAN: Okay. And market conditions, how quick and often do market conditions change?

MR O'HARA: Well, depending on – if you – the grocery channel, for argument's sake, in the alternative markets outside of supermarkets, if you like, can change quite rapidly, in a matter of weeks; and a lot of that is driven by supply. In other words, if there's an oversupply, the prices come down. If there's a short supply, the prices tend to go up. Supermarket chains, because there's contracts in place, that's a different matter. It's normally once a year.

MR O'DONOVAN: Okay, and is that only in relation to their private label products, or is that also in relation to the contract to supply brand products?

MR O'HARA: No, private label.

MR O'DONOVAN: Okay, all right. Now, just in terms of relative size, how big is the non-supermarket chain for eggs; how big is the rest of the market if you take out Coles and Woolworths?

MR O'HARA: Our estimates – and you've got to understand that in the egg category it's a very – well, it's one of the last frontiers, if you like. There's not a lot of information out there. So our guestimate internally would be somewhere in the order of about 53, 54 per cent.

MR O'DONOVAN: Is the rest of the market?

MR O'HARA: Is the rest of the market.

MR O'DONOVAN: Right, okay. And does that include food service, restaurants, hospitals - - -

MR O'HARA: Yes, yes. We take – just so you understand, when we take the mass volume of eggs in Australia we know roughly how much goes into supermarkets, and the rest it could turn out to be shell egg sold, it could be turned into pulp for restaurants, it could be turned into ingredients for cakes.

MR O'DONOVAN: Right, okay. And do you have any feel for which of the two supermarkets – not for your company in particular but in the market generally – has the higher percentage of the market?

MR O'HARA: Well, I mean Woolworths is definitely the market leader.

MR O'DONOVAN: Right, okay. Do you have any estimate of how much of that 47 per cent that is sold through Coles and Woolworths, how much would go through Coles and how much would go through Woolworths?

MR O'HARA: Look, off the top of my head, no. But, you know, they would have at least ten share points over Coles, and Coles would have probably a few share points over the independents.

MR O'DONOVAN: Okay, all right. Now, in terms of the – I suppose setting of price in all other channels apart from the major supermarkets, what dictates the price of an egg in those channels?

MR O'HARA: Mainly – well, there's a couple of factors, but the biggest one is definitely the supply. As you would be aware, we've gone through a drought situation. That certainly did affect the supply which, in turn, affected the price.

MR O'DONOVAN: Right. And I suppose what's the process in which that price is bid up; who's ordering and in what context are they ordering; how is the signal sent to you that you can put your prices up?

MR O'HARA: Well, we obviously go in the marketplace and we're selling to a range of customers. This is non-supermarket. And, you know, our price would be out there and all of a sudden we see that we don't have enough eggs which means there's a run on our eggs which would tend to suggest that the price is too low. And it works the opposite when all of a sudden you start losing customers. So it really is that open market economy. It just – you know, it will fluctuate like that and it can change within two weeks.

MR O'DONOVAN: Right, okay. Now, then – and is a proportion of what you're selling to that other part of the trade, is that your branded products?

MR O'HARA: To the general trade?

MR O'DONOVAN: Yes.

MR O'HARA: Yes. We sell branded product to both the supermarket channel and also the alternative market as well.

MR O'DONOVAN: And what are the branded products that you sell?

MR O'HARA: Well, in the supermarket channel we sell under the Sunny Queen brand, and in the alternative market, although a lot of people call it the box market, we sell a Meggles brand – Meggles, M-e-g-g-l-e-s.

MR O'DONOVAN: And does that go to independent retailers, the Meggles brand?

MR O'HARA: Yes. Some Sunny Queen does go to the bigger independents, but normally it's Meggles brand.

MR O'DONOVAN: Right, okay. And when you say bigger independents, what size of an independent would stock a Sunny Queen egg?

MR O'HARA: Well, normally it's the Super IGAs that would be the category, or a large single independent. Now, if you walked in there as a consumer and you looked at it and said, yes, this is a big supermarket, that's probably where we would tend to focus the supermarket style brand.

MR O'DONOVAN: Right, okay. All right. Now, then looking at the relationship with the major supermarkets, how long have you been involved in the business?

MR O'HARA: I've been involved with Sunny Queen for approximately five years.

MR O'DONOVAN: Now, at that stage were house brands as prominent in the categories as they are at present?

MR O'HARA: Just before I joined, the house brand shifted from being 20 per cent or 30 per cent of our business to about 80 per cent of our business.

MR O'DONOVAN: Right.

MR O'HARA: So it happened just before I got there.

MR O'DONOVAN: Okay. And that's - and does that structure remain roughly the same at present?

MR O'HARA: This is in our supermarket business, yes.

MR O'DONOVAN: Yes.

MR O'HARA: We do have a box market business which we've now grown to try and offset the supermarket market share, if you like, of our business.

MR O'DONOVAN: Right, okay. Now, then in selling to the supermarkets your branded products, how do you go about deciding what's an appropriate price?

MR O'HARA: Well, obviously we look at our overall mix of business and we research the marketplace, and we try to pitch our price I suppose in the area in which consumers would expect to pay for a branded product.

MR O'DONOVAN: And do you have to go through I suppose a category management exercise with the supermarkets where they say: come and tell us what egg products you're going to put on our shelves?

MR O'HARA: Yes, normally about once a year they'll have a category review and at that point in time you put your new products forward, and they either say yes or no depending on whether it ticks their hurdle rates.

MR O'DONOVAN: And when you say hurdle rates, is that in terms of margins and volume that they want?

MR O'HARA: Margins, projected volumes, support for the brand; yes, those three things would be the major ones.

MR O'DONOVAN: Right, okay. And have those hurdles been getting higher?

MR O'HARA: Not of recent times. Certainly they're looking for more support behind the brand, including price promotions I should say. And, you know, the level of the price promotion has certainly shifted. So it's gone from about five per cent to, say, 12 per cent. So if you want to put a special on, you've got to put enough behind the case deal to drop it by 12 per cent.

MR O'DONOVAN: Right, okay. And how often would you run a promotion in that order?

MR O'HARA: Depending on the type of egg, because we sell, you know, everything from caged to organic free range, and normally your standard item – which is your caged egg – would be promoted probably – you know, you've got three or four sizes so each size would get a promotion probably once a quarter.

MR O'DONOVAN: Okay. And once you're in the category, you're in it for 12 months; is that generally the case?

MR O'HARA: Generally the case, unless they see it as under-performing and then they would have a discussion with you about that.

MR O'DONOVAN: Right, okay. And at any time in that 12 months you can change your standard wholesale price?

MR O'HARA: Normally we can, providing we give them four weeks notice. And we tend to try and justify the reasons why we need to move our price.

MR O'DONOVAN: And in terms of setting your wholesale price, what's the – is that the same price that you would be giving to other – to everyone else who buys, say, the Meggles eggs through the other part of the business?

MR O'HARA: With the supermarket brand, because we put more advertising dollars behind it, it's probably pitched to a little bit higher. Plus it tends to not – to move as quickly as the other marketplace. The alternative market or box market is a very - as I say, is a very fast moving feast at times and if you don't react quickly, you can be left wanting basically.

MR O'DONOVAN: Right, okay. So does the market concentration at the retail level where you've got two very big players, does that have any adverse consequences in terms of how you can price your branded product through that channel?

MR O'HARA: No, not really. We try to – as I said, we do market research with consumers and, you know, we tend to pitch ourselves obviously above the private label brands for a number of reasons. One is that we try to promote our better products. We spend money on advertising to get people to eat more eggs. So there are high costs involved, if you like.

MR O'DONOVAN: Right, but broadly speaking you don't see it as a problem for your business having such a large concentration in – or having so few customers I guess at that retail level?

MR O'HARA: I would prefer more.

MR O'DONOVAN: Right. Are there any specific disadvantages you can think of?

MR O'HARA: Well, the biggest one is if you're out of favour, if you're not meeting their hurdle rates, the possibility of deletion of your product or not winning a contract is – you know, is quite immense and the downside is enormous, particularly – see, we're in a live animal product industry, we can't turn the eggs on and off, you know. So it's pretty important for us to make sure that we have a good spread of business.

MR O'DONOVAN: Right, okay. Now, then looking at how you go about pricing your – the house branded products, can you just describe the process of how that's done?

MR O'HARA: Well, the two major supermarket chains call for tender normally once a year, although last year Coles called for a tender which went for two years; Woolworths is still one year. Normally they hold that tender process about four months out from when they want to make a change, and normally they give you three months notice of – to say, look, here's the result, this is what you've got and not got, you've got three months to make the appropriate changes.

MR O'DONOVAN: Okay, and is that enough time to sort out the number of chickens you've got and the number of eggs your producing?

MR O'HARA: If we were to lose a major amount of business, no. That's why we try as a business to spread as much as we can but, yes, I mean, if we lost the major proportion of one of those it would cause us a lot of pain.

MR O'DONOVAN: Right, okay. And take, for example, the two year contract that Coles put out to tender, was that a fixed price tender for the whole of the two years?

MR O'HARA: Look, from recollection, we can certainly go back at any time during that process to say, look, here's the situation - particularly grain - at the 12 month market, and say, look, this is an issue. And we would then negotiate hopefully - whether it would be a price increase or a price decrease.

MR O'DONOVAN: Right, okay. Well, let's talk about the grain situation for a minute. Our understanding is the price of grain in the last 12 months has jumped from $250 a tonne to $450 tonne. Is that consistent with your experience?

MR O'HARA: Yes.

MR O'DONOVAN: What's the impact on that kind of a jump on the costs of producing an egg?

MR O'HARA: Depending on the farmer – and I'm not a farmer but obviously I work with them – it represents between 60 and 70-odd per cent of their operating costs. So it's significant.

MR O'DONOVAN: Right, okay. And when you get a jump like that, what are you able to do in terms of your contracts with the major supermarkets?

MR O'HARA: Well, look historically over the last few years, particularly when it was going through that jump period, you know, we were able to go back to Coles, for argument's sake, and renegotiate a price increase. Woolworths put their business out to tender because they said it was too much, so they went back out to the marketplace. So it's horses for courses, it just depends on how they feel at the time as to whether or not it's suitable to their business I suppose.

MR O'DONOVAN: Right, okay. But you're not locked in producing eggs at a non-economic price for long periods?

MR O'HARA: Well, depending on when we win contracts and – it is possible that – I mean we have suffered in the past in not getting it right and not being able to get a price increase.

MR O'DONOVAN: Right, okay. And when that happens, does that then change your pricing approach to other products that you sell? Does it force you to put up prices elsewhere in your business?

MR O'HARA: Well, I suppose in the alternative markets where it's more flexible, what tends to happen again if it shortens up – and normally what happens is people start killing birds so it does shorten up – we will then take a price increase there to try and balance. But, as I said, it also works the other way; when it comes on abundantly, that will be the first market that reacts.

MR O'DONOVAN: So, again, market conditions in the other markets may prevent you from actually shifting your margins elsewhere.

MR O'HARA: Yes.

MR O'DONOVAN: Okay. Now, then in terms of the weightings at the retail level, you indicated that I think in the five years it shifted from – had it just shifted to 80 per cent of your business, the house brand?

MR O'HARA: That's right.

MR O'DONOVAN: Okay, having been a much smaller proportion in the previous five years.

MR O'HARA: Yes. Well, Sunny Queen five or six years ago was predominantly a supermarket focused business, so it sold the majority of its eggs through the supermarket channel that – the chain channel. And when I arrived the switch had happened and I suppose one of the tasks that I set out to do was to reduce the risk or the reliance on that particular channel sale, and look at other alternatives. So, yes, it was – it had changed from 80 per cent branded to 20 per cent branded.

MR O'DONOVAN: Okay, and in having that change did it result in a substantial shift in your margins? Did it put downward pressure on your margins?

MR O'HARA: Yes.

MR O'DONOVAN: Right, okay. And from your observation, was that reduction in your margin then reflected in a reduction in the margin at the retail level?

MR O'HARA: At the time, yes.

MR O'DONOVAN: And what's happened since then in terms of your observation of retail margins? Have they grown in your five years?

MR O'HARA: My recollection is that they've been fairly consistent over that period of time.

MR O'DONOVAN: Okay, and are house brand eggs a low margin product, looking at it from a retailer's point of view?

MR O'HARA: Well, it depends on what you call low margin. But it is not too dissimilar to what they make out of branded product.

MR O'DONOVAN: Right, okay. But the actual price at which they sell it is much lower?

MR O'HARA: Is lower.

MR O'DONOVAN: Reflecting a much lower cost of supply.

MR O'HARA: Correct.

MR O'DONOVAN: Okay. And in terms of price competition in eggs, do you see the major supermarkets putting pressure on each other's margins in eggs?

MR O'HARA: Yes. Yes, I have.

MR O'DONOVAN: Right, and is that when they get a pricing advantage in the supply or just as way of – or are there other reasons and other ways in which they can do it?

MR O'HARA: Look, a combination of depending, you know, their competitive set. They certainly move their prices to adjust to a competitor. And, of course, I suppose they also have a good look at their house brand pricing after a contractual period.

MR O'DONOVAN: Now, it's been put to us in at least one submission that using ABS data it shows a very flat farm gate price, but substantial above CPI and even above food CPI inflation in the egg market. Is that your experience of the retail market, that there has been significant and above CPI inflation in the retail market for eggs?

MR O'HARA: Yes.

MR O'DONOVAN: Right, and why has that been the case?

MR O'HARA: Predominantly driven by the grain pricing, is all I can put it down to.

MR O'DONOVAN: Okay, but that would presumably only emerged – have emerged in the last 12 months?

MR O'HARA: No, I'd say coming up to 18 months now.

MR O'DONOVAN: Okay.

MR O'HARA: Yes.

MR O'DONOVAN: But the first three and a half years was it present?

MR O'HARA: No.

MR O'DONOVAN: No, okay. So is there – I mean the submission that has been put to us is that this flat farm gate price and this high – but this high level of inflation reflects some kind of price gouging going on at the retail level. Is that consistent with your experience?

MR O'HARA: No, because, you know, with our farm gate pricing, it has moved up and down I suppose with the contracts to the supermarkets so, you know, farm gate pricing hasn't been static, in my view anyway; and neither has the retail pricing.

MR O'DONOVAN: Right, and is there broadly a correlation between the farm gate pricing and eggs in the retail pricing, do they move together in your experience?

MR O'HARA: Well, again normally what happens – or what has happened in the past is that – and for us it has been the drought. When we have gone back and put a case to the major retailers, and received the price increase to cover the cost of grain, normally that has been reflected in the shelf price.

MR O'DONOVAN: And when things go the other way, when there's an oversupply and farm gate prices drop because of the oversupply, do consumers get the benefit of that?

MR O'HARA: They do.

MR O'DONOVAN: All right. Now, in relation to eggs, obviously there's more breakage with them than other commodities, and I think – and that's accounted for in terms of – I think the description is ullage?

MR O'HARA: Yes.

MR O'DONOVAN: Okay. Now, can you indicate just what – firstly, what the arrangements in respect to ullage are in relation to a proprietary brand when you supply to a major supermarket?

MR O'HARA: Well, they are different for – depending on what you call – are you just talking Coles and Woolworths here?

MR O'DONOVAN: Yes. Start with Coles and Woolworths.

MR O'HARA: Yes. I would need to answer that confidentially if I could, please.

MR O'DONOVAN: Okay, all right. Yes, well, I think I've just got two other questions but I think they are both largely confidential.

THE CHAIRMAN: I just want to check some of these pricing movements that we've been talking about. What is the base egg today? How would you describe the base egg that you buy; you know, No Frills egg?

MR O'HARA: A caged egg, either six or seven hundred gram.

THE CHAIRMAN: And home brand?

MR O'HARA: And home brand, yes. Home brand or the Coles - - -

MR O'DONOVAN: Smart Buys?

MR O'HARA: Smart Buy, yes.

THE CHAIRMAN: Yes, and what does that sell for generally retail at the moment?

MR O'HARA: From memory it's about 2.39.

THE CHAIRMAN: Okay. It's actually come down since the last bit of evidence we got, it was 2.59 the last time we heard evidence a few weeks ago, so it has dropped a bit.

MR O'HARA: Yes, but it still could be 2.59.

COMMISSIONER MARTIN: You hadn't picked it up when you went shopping.

THE CHAIRMAN: I'll get it there and get a special, but subject to what Mr Reitzer can supply us later on. Okay. What was the – because we're trying to do some – you see, what we're getting put to us is that there has been a vastly inflated price of eggs over a 10 or 15 year period that has fast outstripped inflation. Can we take you back now to your No Frills egg of 10 years ago.

MR O'HARA: Yes.

THE CHAIRMAN: What would it be?

MR O'HARA: Look, I'm sorry, I just wasn't around but it was, you know – all I know is that up until recently I know eggs have been one of the cheapest products you can get on the market, compared to everything else from – you know, I read it in the newspaper somewhere, if you can believe all that, but – so, yes.

THE CHAIRMAN: Now, just from my own experience, I notice that there are all sorts of – I have given you – talk about the No Frills, and then we've got the super frills with all sorts of omega and everything else put into it. So if we were to take the super frills egg, what would it be?

MR O'HARA: Well, if you were to take an organic egg, it could retail for around about, you know, eight and a half dollars for a dozen.

THE CHAIRMAN: Eight and a half dollars?

MR O'HARA: Yes.

THE CHAIRMAN: And if we were to look then at the percentage of eggs sold that are at the No Frills end, and then sort of grade it up to the super frills end, just in approximate terms what's happening?

MR O'HARA: Yes. Well, the caged end, if you like, the base egg, it represents about 70-odd per cent of the market. Free range represents about 15 per cent of the market. And 70, 15 and – what else have you got? You've got barn probably on 3 or 4, and organic on 3 or 4, and then you've got the rats and mice.

THE CHAIRMAN: Okay, and is there a discernible difference in quality between the home brand No Frills egg, and the branded No Frills egg?

MR O'HARA: Depending on which category, discernible difference, probably not.

THE CHAIRMAN: All right. We will clear the room if we can just for two or three confidential questions, and then we will be resuming back about 10 o'clock with the Metcash group.

CONTINUED IN TRANSCRIPT-IN-CONFIDENCE

CONTINUED FROM TRANSCRIPT-IN-CONFIDENCE

RESUMED **[10.09 am]**

THE CHAIRMAN: All right. We will resume this hearing with the representatives from Metcash and I welcome Mr Reitzer and other representatives and we will get your introduction just in a couple of minutes. Just before you arrived before, and I do want to thank you very much for coming down here to be present today, but I did note just some procedural issues. You have received, I think, a document that is outside on the table there that outlines how we intend to approach the hearing so I won't go through those procedural points in detail. I just want to emphasise that although we are not taking evidence under oath at this hearing it is a serious offence to give false and misleading evidence to the ACCC.

In relation to confidentiality, if a witness believes that a particular question or a series of questions are likely to result in a disclosure of confidential information, then the witness should indicate an objection to answering the question on that basis. I will then consider whether the inquiry should take evidence in private, and although it is our wish that as much as possible evidence be given in the public arena, there will be an area where potentially commercially sensitive information is to be provided and we will then move into a private closed session.

We are not using external counsel at this hearing. The witnesses will be questioned by the ACCCs internal lawyers, Mr Damien O'Donovan assisted by Ms Catherine Freeman. Can I thank you once again, Mr Reitzer, and your colleagues for attending, and hand you over to Mr O'Donovan.

MR O'DONOVAN: Thank you. All right. Can I get each of you to state your name, your position in the company and the company you represent?

MR G. WATSON: Greg Watson, general counsel, Metcash.

MR A. REITZER: Andrew Reitzer, the CEO of Metcash Limited.

MR S. LENNON: Scott Lennon. I'm a partner with PricewaterhouseCoopers.

MR O'DONOVAN: Now, I just need to confirm that you understand that it is an offence under the criminal code to give evidence that is false or misleading or which omits matters without which the evidence could be false or misleading. Do you each understand that?

MR REITZER: I understand.

MR LENNON: I understand.

MR O'DONOVAN: All right. Now, if I can just briefly go through with you what the Metcash business is. As we understand it, Metcash is the - - -

THE CHAIRMAN: Does Mr Reitzer want to make a preliminary statement?

MR O'DONOVAN: Yes, sorry.

MR REITZER: Thank you, Commissioner. Thank you, Mr O'Donovan and Ms Freeman. Many thanks to yourself, to the Commission, and to Commissioners King and Martin for the opportunity to appear today on behalf of Metcash and the independent retailers and we supply as part of this inquiry. Metcash welcomes this inquiry. We believe there is a strong alignment in objectives of both Metcash and the objectives set by Minister Bowen of this inquiry and that we are both trying to ensure working families are getting a fair deal in the supermarket by promoting genuine choice beyond the two major chains.

Our written submissions to this inquiry highlight the areas where the ACCC can do more to enhance competitive tension in the market for basic food items, and by way of this opening statement, Mr Chairman, I would very much like to address four key things, one being the important role of Metcash in improving consumer choice and competition; the second one, the relationship between Metcash and the independent retailers; the third one, whether Metcash is providing independent retailers with competitive prices; and then lastly, the anti-competitive impacts of a highly concentrated Australian retail grocery market.

If I could talk about the first one, the important role of Metcash in improving consumer choice. Metcash is the champion of the independent retailer. We focus on providing marketing and distribution of food and groceries to independent retailers. Our core job is to combine the volume of all independent retailers to negotiate as hard but fairly with manufacturers and to pass these buying advantages on to all our retailers so that they can be the genuine third force and compete effectively with the two major chains.

We have progressively grown our business by 76 per cent and from wholesale volume of five and a half billion in 2001 to 9.7 billion in the last 12 months. Over the same period the market share of our retailers has risen from 11 per cent to 18.7 per cent as of last month and we have achieved this rising market share by doing two things: the first thing is price competitiveness of our independent retailers which has improved as a result of the economies of scales, the systems and the investments that we have made in the distribution facilities; and, secondly, by enhancing the quality of a variety of branding and marketing of our product range and the stores operated by independent retailers and that we support.

These focuses enable our retailers, particularly the Super IGA stores, to go toe to toe with the two major chains. Whilst it is definitely unfortunate that average grocery prices have been rising and these rises were not driven by any significant change in our wholesale margin or the margin of our retailers, rather they are caused by a multitude of factors and which we go through in our submission but essentially which go around the rises in the cost of raw materials, major commodity price increases, fuel, labour, rents, you know, a whole variety of cost push inflation.

Second, in terms of Metcash's relationship with the independent retailers our job is to build a strong independent retail industry. For Metcash to be successful it is crucial that our retailers are successful. Our approach is to provide substantial assistance to independent retailers to aid their success in the form of advertising, promotions, specials, advice on layouts, branding, just to name a few. If Metcash does not deliver a reliable service and with high quality products at competitive prices, then our independent retailers will not be sustainable and will not be free to seek alternate supplies, and this freedom of absence of so-called wholesale power by Metcash was clearly evidenced when one of our largest customers at the time, Franklins, decided to set up their own supply route and we the champion of the independent retailer and IGA focus on the local heroes program and that sort of commits our commitment to the unique business model which takes the pooled volume of all independent retailers and their entrepreneurial spirit to compete for the major chains.

Independent retailers ..... buy something like 35 to 50 per cent of their products elsewhere and they are able to join banners like FoodWorks providing them with a choice in merchandising systems, pricing methodologies and a different rebate arrangement so they can - independent retailers can rely on themselves with a banner like IGA or a banner like FoodWorks or just trade under their own name and many of them do and every single day Metcash has to earn the right to supply its retailers and through having highly competitive price, service and quality.

Then, thirdly, just in terms of the question of whether Metcash is providing the independent sector with competitive prices. In relation to this and the demonstration of competitive prices by Metcash, these hearings have been presented with a range of views which endorse independent retailers particularly the Super IGAs as in the words of Mr McMahon from Coles to this inquiry last Monday, he said that they are formidable competitors. And further, Mr Noble from FoodWorks, our largest customer, stated that Metcash in this last 10 years has done an outstanding job. They have helped efficiently rationalise the industry, their operation is support all independents, customers of theirs generally very efficiently, infrastructure, the new warehouses; all those sorts of things. So I think Metcash would get a lot of credit for the work they have done in this industry and FoodWorks has been a beneficiary of that.

Metcash supplies a diverse range of groceries from the Super IGAs while formidable competitors to the two major chains and they account for about 70 per cent of Metcash's sales. Future convenience stores like IGA Xpress, 7-Eleven who provide customers with quick, easy, you know, convenience format. In championing the cause of independent retailers, as I said, Metcash combines all their volume and we charge the same wholesale list price to all our customers. We don't have a different price for bigger stores or for smaller stores. And during the course of this inquiry, I've noticed some mention given to the difference in check out prices being Super IGAs and the smaller stores.

This is unrelated to the cost of the goods charged by Metcash and reflects many more factors related to the fact that it is a full supermarket of this completely different business to a convenience store. These factors include lower customer numbers, different customer needs, lower average customer spend, greater labour cost, higher rent. They are just totally different businesses which are resulting in different prices being charged.

Then lastly, Mr Chairman, I could go through the impacts of a highly concentrated grocery market and check consolidation in the grocery industry has allowed the two major chains to use the combined market share of 76.3 per cent. This cosy duopoly has led to weaker competition in the retail market through a lack of choice for Australian consumers. On a local level many consumers have little choice but to reluctantly accept the retail offer of major chain outlets in their area. With no large independence in the area the consumer is vulnerable to price increase as well as declines in quality.

The major chains often point to the availability of food from retailers such as butchers and fruits and veg shops as evidence of their smaller share of the stomach, but consumers in Australia remain heavily dependent on the traditional supermarket for the bulk of their purchases. The entry of ALDI has had only a minor effect on the major chains. Most consumers do not view it as a genuine alternative to a full supermarket hence Super IGAs remain the only genuine prospect to becoming a true third force.

Metcash's written submission to this inquiry also raise our concerns about the impact of creeping acquisitions with the major chains readily buying independent retailers to call on particular markets and then fund these by lifting prices once consumer choice has been eradicated. We have a live example right now of this in the Woolworths proposed acquisition of the Karabah Superbarn in the ACT. Prior to making a decision on Karabah, we suggest the ACT – ACCC undertake some ex-poste price change analysis of areas where supermarket – where creeping acquisitions have been endorsed.

Metcash has also long been aware that supplies have little bargaining power in Australia in their dealings with the major chains. The dominance of the two major chains means there are two few alternative distribution outlets for suppliers and growers. Delisting of suppliers products by a major chain can seriously impair the supplier's viability. In the long run the concentration on market power within the two major chains hurt the Australian consumers.

In summary, Mr Chairman, Metcash and the independent retailers would be very, very proud to support to create competitive tension and provide a genuine competition to the two major chains. Metcash works hard to leverage the combined volume of independent retailers being 18.7 per cent of the market to get them the best possible deal which we then pass on to them irrespective of their size. We look to the Commission's report to focus on reforms which enhance competitive tension to reduce the negative impact of a highly concentrated retail grocery market on working families, growers, manufacturers and small businesses. Thank you very much.

MR O'DONOVAN: Let us begin with I suppose a broad description of Metcash. It is essentially the wholesaler to the vast majority of independent retailers in Australia. Is that right?

MR REITZER: Yes, that's correct. In terms of the grocery market Metcash has two divisions that service the grocery market. The first is IGA distribution which services independent retailers that combine full cases and they would go from small stores of about 500, 400 square metres like IGA Xpress and certain FoodWorks stores all the way through to four and a half thousand square metre markets – supermarkets that trade under the Super IGA brand. It has about 4000 accounts of which about 1300 traders IGA, about 700 stores traders FoodWorks.

We then have a second business channel that is included in the market share that I spoke about called Campbells Cash and Carry and they essentially service stores that do buy some products in full cases but they need to turn their stock very quickly so they buy less than a full case load and they would service customers like 7-Eleven, BP Express, Mobil Quix, Night Owl and many, many mum and pop traditional kind of convenience stores.

MR O'DONOVAN: So in terms of understanding the supermarket market the important element of the business is the IGA distribution element?

MR REITZER: That's correct.

MR O'DONOVAN: And if you are an independent retailer wanting to operate a supermarket, in Australia really you don't have any choice other than to deal with IGA distribution. That's right, isn't it?

MR REITZER: No. You do have certain choices. We have a competitor in Queensland called ARRL that – their brand is small, so if you were in New South Wales or Queensland you could buy from them, and for your basic – you know, but other than that in other States you would be correct in that for the broader range of dry frozen and chilled groceries it would be hard to beat the price and service that you get at Metcash. Many of our retailers though, as I did mention in my opening speech, buy somewhere between 35 and 50 per cent of their purchases elsewhere so other wholesalers, route trades, directly from manufacturers of van sales, the fruit and veg market.

MR O'DONOVAN: But if you want to be a supermarket in say Victoria.

MR REITZER: Yes.

MR O'DONOVAN: And want to buy packaged groceries, there is really no alternative but to deal through Metcash?

MR REITZER: In terms of price service?

MR O'DONOVAN: Through IGAD.

MR REITZER: Price service and quality you wouldn't be able to beat Metcash.

MR O'DONOVAN: And if you were unhappy with Metcash and you had initially signed up with Metcash and was unhappy with any of those elements, you wouldn't have any choice anyway, would you?

MR REITZER: If you were an IGA store and you were unhappy with Metcash I would say you've got three choices: one would be to resign and join FoodWorks which is a parallel branch and has different - - -

MR O'DONOVAN: Can I just stop you there. Even if you switched to FoodWorks you would still be buying your product from IGA distribution.

MR REITZER: Yes, but you are marketing and deals and co-ops are different so many retailers don't like what IGA do so they join FoodWorks and vice versa.

MR O'DONOVAN: But just to be clear, but IGAD would still set – still sets the wholesale price?

MR REITZER: The base wholesale price, yes; the same for everyone.

MR O'DONOVAN: So that's the first alternate. Sorry, I interrupted. And the other two?

MR REITZER: The second, so you could sell to FoodWorks, you could become an unbranded store so just do your own marketing and do your own branding as many of our retailers do. The third is sell your business.

MR O'DONOVAN: Just to stop you there. But again you still have to buy your grocery products from Metcash?

MR REITZER: Yes, some of them because price service and quality wouldn't be able to source it anywhere else.

MR O'DONOVAN: Sure. Okay. And, sorry, the third option?

MR REITZER: Is to sell your business.

MR O'DONOVAN: Sell your business. Okay. So realistically if you want to operate a supermarket you've got little choice if you are independent other than to deal with Metcash?

MR REITZER: I would say that's correct.

MR O'DONOVAN: All right. And in that sense you operate a monopoly at the wholesale level?

MR REITZER: From that point of view I think you are correct although there are two things that you are assuming by saying the word "monopoly". The first is that the retailer doesn't have a choice and the second is that we have pricing power over the retailer. The retailer has a choice. I have outlined some of the choices and some of our retailers' buyers – supermarkets' buyers little as 30 to 40 per cent of their requirements from us. So they bypass the Metcash channel for a variety of retailers. Some retailers buy 85 per cent of their purchases from us. Also, you know, we can't – we don't force anyone to do anything.

And the second assumption in saying the word "monopoly" is that we can charge the retailers whatever we like which is not the case because the real competition as found by the competition tribunal up in Queensland with the QIW case is at retail and if I wanted to increase Metcash's profits I could do - and double them, I could do that tomorrow and in a few months' time no independent retailer and Metcash wouldn't have a business left because the real competition is at retail level and it competes with the two major chains. So the constraint in saying the word "monopoly" comes from the retail level in terms of what our prices are, what our promotions are, how much we can charge for service fees. That's where the competition is.

MR O'DONOVAN: So the competition at the retail level provides some constraint. Is that - - -

MR REITZER: Significant constraint.

MR O'DONOVAN: All right. But the evidence that we've heard during this inquiry is that notwithstanding that constraint that Metcash effectively supplies goods at a price which doesn't enable the retailer to win any margin at all if they are to be price competitive with Woolworths or Coles? Would you agree with that?

MR REITZER: Absolutely not.

MR O'DONOVAN: Let us just go through the evidence that we have seen. The first one came from John Cummings who is representing NARGA and he indicated that there was no margin to be made in the products that were supplied by Metcash, that the margin was made on all the other products, so the other 50 per cent that they can supply elsewhere and that that was how a store became profitable. So that suggests, doesn't it, that Metcash prices up to the margin and takes all of the margin that is available in its products and requires the retailer to earn a margin on other products not supplied from Metcash. Would you agree with that assessment?

MR REITZER: Absolutely not, and all the information and all the retailers P and Ls and I see many, many of them, also did a significant study with PwC suggest exactly the opposite.

MR O'DONOVAN: Now, when you say the “significant study”, do you mean the field of terms of engagement study?

MR REITZER: That's correct.

MR O'DONOVAN: Now, I assume that is a confidential document?

MR REITZER: Yes, please but I can go through it in a closed session.

MR O'DONOVAN: All right. Now, in addition to that we have heard the Franklin’s evidence which was effectively that they could not at the prices at which Metcash were supplying compete directly with Coles or Woolworths and they were so convinced of that proposition that they left the Metcash group and set up their own retail in response to the poor pricing they were getting from Metcash. Doesn’t that suggest that indeed the behaviour that John Cummings was describing was exactly the same experience that Franklins had?

MR REITZER: Absolutely not. The method of charging Franklins was totally and completely different to the rest of the banner groups and the other independent retailers we supply. Franklins requested from us that all we are is a box mover so we just performed the job of a distributor, we did none of their promotions, none of their case deals, collected none of the confidential trading terms which is the big money in this industry and they did that all on their own and in terms of the profitability of an account we made somewhere between a quarter to one third of the profit out of them initially to help them get on their feet that we would after the FoodWorks retailer or an IGA retailer and they acquired 70 of the old Franklins, the dairy from Franklins stores – 50, I beg your pardon – and we gave them a very, very sweet deal to help them get on their feet but unfortunately it didn’t work.

So that argument really doesn’t hold water I charged hundreds if not thousands of other retailers on the same basis but they were members of IGA or FoodWorks or free standing stores and their profitability is a significantly, quite an attractive level and if you look at all the reinvestment that’s going on in the independent sector they wouldn’t be reinvesting in businesses where they make absolutely no profit on the goods they buy from Metcash so it’s totally contrary to that. And then I think, you know, you have to judge Franklin s’ decision by what happened to their business after they left us.

It has been reported in the newspaper, I can't remember the figures. They lost millions of dollars since then and continued right up until the last sets of results which I think I read about last month to lose money, and their sales have fallen from about a billion dollars of retail when they were our customer and I think I read in the newspaper that they are 800 million now. So they have had a 20 per cent decline in turnover. You know, surely they can't blame that on Metcash.

MR O'DONOVAN: All rig ht. But it is true that when they were operating under the Metcash deal that they were losing money even when Metcash was supplying them.

MR REITZER: Yes.

MR O'DONOVAN: And the forced leaving of Metcash forced them to put substantial capital investment at very short notice into a distribution centre and then Metcash effectively refused to supply them in any transitional way which created specific retail problems for Franklins, would you agree, that all of those elements occurred?

MR REITZER: Unfortunately that isn't quite accurate. They had to give us 12 months' notice which they did and we serviced their business up until the last day absolutely in full on time with no deterioration whatsoever. We also, if you remember, carried a very substantial range of No Frills products. Their brand I think is called No Frills which we had to carry and when they left we – there was no one else that we were allowed to sell that to. We were in stock of every single item up until the last day and they had approximately 12 months to plan and set up an alternative which they did.

We then met them and said, "How would you like to spread the movement of the stores to other DCs because we've done this many times before and it's a very difficult process so shouldn't you do like 10 stores a week? So start, if there is a cut off stock, stores going earlier and then some stores can carry on buying from us, we don't mind, spread it out," and it was their choice and they said, "No, on that loss though you will deliver all the orders and the next day you'll get none." So it was their choice to switch overnight which we advised them and we said that's a very difficult thing to do but it was their choice. It was not our choice. We offered them to go gradually. So I would disagree, and they had approximately a year and I am aware as things often come out after the deal is broken of what they were doing and who they were talking to and the plans they made, so the plans were actually longer.

MR O'DONOVAN: Now, you have indicated that you let them collect their confidential terms. So there's the - - -

MR REITZER: We didn't do it.

MR O'DONOVAN: Let's go back a step.

MR REITZER: They requested that. Yes.

MR REITZER: All right. Just so that we can understand. So their conception was that you would just collect. You would just be the box mover for them at a fee and that they would handle the negotiations with the suppliers?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. And the way in which terms are done in this industry is that there are public terms which appear on the invoice?

MR REITZER: That's correct.

MR O'DONOVAN: Which everybody knows about and then there are confidential terms which are agreed between Metcash and Franklins and the actual supplier and those are confidential terms?

MR REITZER: That's correct.

MR O'DONOVAN: And they fall into a host of different categories?

MR REITZER: Yes.

MR O'DONOVAN: Okay. And it’s true to say that Franklins was allowed to negotiate in respect of some of the confidential terms?

MR REITZER: All of them.

MR O'DONOVAN: All right. But there were confidential terms which Franklins retained the benefit of?

MR REITZER: Franklins retained the benefit of all the confidential terms.

MR O'DONOVAN: Sorry. Which Metcash – but there were also confidential terms which Metcash negotiated direct with suppliers in respect of Franklins volumes which Metcash retained the benefit of?

MR REITZER: Yes.

MR O'DONOVAN: So it’s not true when you said earlier that Franklins retained all the benefit of the confidential terms?

MR REITZER: Yes. There were approximately six or seven confidential terms that manufacturers would give you if you had a warehouse so you had to own the warehouse to have them. They related to a certain warehouse to encourage you to behave in a certain way when you ran the warehouse and ordered the stock and Franklins knew about them. We advised them on day one and they agreed and we collected those. They were absolutely minute. I don't think they came to five per cent of the confidential terms but you have to own a warehouse. If you don't own the warehouse you don't get those.

MR O'DONOVAN: Okay.

MR REITZER: But the - - -

MR O'DONOVAN: Just let me stop you there. Five per cent in this – in the supermarket business is a huge difference, the difference from being profitable and not profitable, isn't it?

MR REITZER: No, no, no. Five per cent of the confidential terms. So if your confidential terms came to – I don't know, let's say $100, $5 related to running the warehouse. It's insignificant. The percentage that they apply to it is totally insignificant in terms of being competitive or the gross amount of confidential terms.

MR O'DONOVAN: So you don't think – well, it's true to say, isn't it, that when Franklins got some sense of the amount that Metcash was making from its volumes that it was unhappy?

MR WATSON: Well, we might need to be careful here, Mr O'Donovan, simply because we are getting into the technical detail of what are absolutely confidential details which is, you are aware, there is litigation on foot at the moment.

MR O'DONOVAN: Yes.

MR WATSON: We need to be very careful that whilst we are trying to be as helpful as we can, we don't start to stray into any of the areas of detail that might impact on the future conduct of that litigation. So if we are going to start sort of drilling into some of the numbers and that sort of think I think we should probably start to do that in confidential session.

MR O'DONOVAN: All right. That's fine, but in relation to the question that I asked it is fair to say that when Franklins got wind of how much Metcash was making out of it they were unhappy?

MR REITZER: No. What Franklins accused us of in terms of the case, and I think I would prefer to answer the question in detail in a closed session, was that we had claimed a number of confidential terms on their volume and pocketed the money and not passed it through to them. So that's why they sued us.

MR O'DONOVAN: Yes. And in essence they felt that that – the money retained by Metcash was the difference between Franklins being able to compete against Coles and Woolworths and not being able to compete against Coles and Woolworths.

MR WATSON: I think now we're getting into that sort of level of detail in which, given the future conduct of this litigation, is likely to be sensitive so I think we should leave that there and deal with that confidentially.

MR O'DONOVAN: All right. So in terms of an independent retailers who wishes to compete direct with Coles and Woolworths, is it your position that the terms on which Metcash supply are adequate for them to do that?

MR REITZER: Yes, with one proviso is that they would have to join either the FoodWorks banner or the IGA banner because what those two banners effectively do is combine all the marketing moneys and provide very effective marketing programs or have a very strong point of difference to be able to complete. So if you are not going to utilise one of those marketing programs you can't build a marketing program on your own for one store but we have many retailers that do not belong to FoodWorks, don't belong to IGA but have another very strong point of difference against the two major chains and that is why they are successful and make a handsome return.

MR O'DONOVAN: But we leave Super IGA aside for the time being and just concentrate on IGA, it's true to say that IGAs generally don't attempt to be price competitive with Coles or Woolworths?

MR REITZER: In terms of competition there are several things that you can do and that our retailers do to be competitive. The first is your normal, everyday shelf price so I would say that, you know, we don't know what our retailers shelf prices are. We just suggest any prices to them, but I would suggest that even in channel, too many of our retailers and many of the food which retailers on everyday shelf prices are there or thereabouts, and they all then participate in promotional activity. They would all have – obviously the IGAs are a little bit less than the Super IGAs but the Super IGAs would have 3 to 4000 items on some sort of promotion every single day of the week.

The IGAs would be a little bit less but not substantially less, like two and a half to three thousand items on some sort of promotion a week and the IGAs do promote in the media, so the newspaper and primarily catalogues and TV but they would promote fewer items than the major IGAs. Those promotional prices are determined by the market or determined by the chains so in an IGA store and similarly in a FoodWorks store although they would do their own, if we're going to advertise product X next week the price at which we advertise it is determined by the chains. If they were advertising it at $1.99 last week you can't go out at $2.30, it would be uncompetitive and we do that or FoodWorks head office do that for the retailer and those are competitive prices.

MR O'DONOVAN: Sure. Well – so sticking with promotions first. So you would agree that IGAs are not price leaders in terms of promotions, that they are effectively – they will follow the prices set by the major chains?

MR REITZER: Yes, but although the price leaders just like Super IGA, in terms of that the item isn't on promotion then. So if we're the only ones out with an advert on product A in that we're the price leader. And that fact that it's at, or slightly below, or two cents below whatever, the price was advertised by one of the major chains last week, that's how the selling price gets determined.

MR O'DONOVAN: Yes, but it's not IGAs goal to be the price leader. It effectively follows the Woolworths and the Coles prices on promotion?

MR REITZER: That's correct. On promotions set by ourselves, although what each and every store does in terms of its prices is – it's their strategy. We have some retailers that have a strategy that says I will just beat any single price out there and they do. And then we have other retailers that say I can't afford to do that, I'll be a follower and I'll execute the IGA promotions. We have other retailers that have, and that's our greatest strength, is the entrepreneurial spirit. They'll take a department or a product every day or every week where they are cheaper. But in such a highly concentrated market where two control 76 per cent, you're not going to get away with, on a national basis, being cheaper across the board.

MR O'DONOVAN: Okay. And if we go to the shelf pricing of the IGAs - the standard shelf pricing, but leaving aside the Super IGAs that are directly competitive - but the standard IGA supermarket, it's not a price leader on the standard shelf pricing is it?

MR REITZER: No, it's a follower – at best it's a follower.

MR O'DONOVAN: Yes, and often it's above?

MR REITZER: Could be, yes. I mean, I don't have those statistics. I can't answer the question accurately.

MR O'DONOVAN: Sure, but in terms of the dynamic that it provides to the market it's not part of its dynamic to push down the standard shelf pricing of grocery items?

MR REITZER: No.

MR O'DONOVAN: Okay. All right. So then if we then go to the Super IGAs, they have – now, they buy at the same price as an IGA. Did I understand you correctly in saying that?

MR REITZER: Yes, if I could just take two minutes to explain how we work, and then you – because when one says at the same price then obviously the question is that the net price after everything. So as you referred to earlier, there are certain terms in Australia that are sort of public terms or published terms. So we take the wholesalers price provided to us by the manufacturer, which we assume is the same as what they charge the chains, and we take off all the published public terms, like trade discounts, quantity buyer discounts, buy a full truck load of a product, cash discounts, the trade discounts I think I have said, and we arrive at what we call at net strip cost, but I mean that's not the correct term but we just call that a net strip cost. And we charge all our customers that price.

If there is a promotion going on, or a case deal from a manufacturer which is always for a limited period – so a manufacturer might come and say over and above all of that there's a promotion, or a special, or whatever it is, there's another $5.00 a case, we take that off as well, and that goes through to every single retailer that buys out of IGA irrespective of whether they're Super IGA, FoodWorks, Independent, they get paid that price. Plus they pay us a service fee, and the service fee is a percentage of that order, and it depends on the size of the order and it's a user pay.

It's a sliding scale service fee. And that's where, from, as a percentage, bigger stores pay a lesser percentage than small stores, because to pick an order, for example, in our Laverton warehouse, you walk 7 – or travel 7 kilometres, and if you end up after 7 kilometres with an order of half a pallet, our costs are much higher as a percentage than if you travel 7 kilometres and you end up with 10 pallets for a store. So that percentage can differ. So that's where smaller stores could pay a higher percentage than bigger stores, then freight belongs to the customer.

MR O'DONOVAN: Okay. And is that the only difference in the terms?

MR REITZER: Then it depends on which banner you join as to what your rebate would be. So if you're an IGA banner there's certain rebates for certain performance, and certain – we pay for the marketing. If you're a FoodWorks they have a totally different set up in terms of what their rebates and how they pay and charge for their marketing. And obviously if you don't join FoodWorks or if you don't join IGA then you get no marketing supporting and no rebates.

MR O'DONOVAN: Right. Okay. So then looking at the Super IGA, the only pricing advantage that it gets over and above a normal IGA is that it gets a lower service fee because of the higher volumes?

MR REITZER: That's correct. If you order in big quantities – so if you send through a small order, you made a mistake with something, you'll pay the high percentage for that one order but, generally speaking, they pay, they organise themselves, and they only place big orders.

MR O'DONOVAN: Okay. And the other advantage that a Super IGA has is that it has a larger range of SKU, stock keeping units. It's just got more – bigger variety of stock?

MR REITZER: Yes, and the biggest advantage would be a much, much stronger marketing program.

MR O'DONOVAN: Sure. But would it be generally true that Super IGA stock a higher proportion of non-Metcash products than your standard IGA?

MR REITZER: That's not – no, that's not a rule, no.

MR O'DONOVAN: Okay. Just numerically, in terms of SKUs, they would stock more?

MR REITZER: Numerically, yes, but sometimes you'll get an IGA Express store that has a fresh participation that's sometimes higher than the best Super IGA, and they wouldn't buy any of those fresh products from us. They buy those from other wholesalers on the market. But if you look at the SKU count, yes. Obviously a Super IGA buys more items from us than a smaller store because the range is bigger.

MR O'DONOVAN: Yes. And if John Cummings is right, and you can't make good margins buying from Metcash, and your profit is all made elsewhere, it's all of the stock that the Super IGAs buy elsewhere that they're likely to be making their profit margin, isn't it?

MR REITZER: But that statements not correct.

MR O'DONOVAN: Okay.

THE CHAIRMAN: When you say it's not correct - sorry, I just want to interrupt here – you're telling me Mr Cummings is making it up? And let me quote you what he said:

> *In effect, if I was to show –*

this is on the public record –

> *if I was to show you, and I would show you privately if that's what you wanted, I would show you my Metcash invoices for one week and I lose money on what I sell out of their warehouse.*

Now, is he making that up. We'll subpoenas his invoices if you like. But is he telling us fibs?

MR REITZER: I can't talk for his one particular store.

THE CHAIRMAN: But he's got three stores though, hasn't he, three IGA stores?

MR REITZER: Yes, I can't talk for three IGA store, Commissioner. I can only talk for the hundreds of profit and losses that I see, and I see the gross margin by department when we receive those from our retailers. We did an intensive study, and – I mean, there are some departments with just – that's the way the industry work – the gross profit percentage, as a gross percentage, is higher than on dry groceries. So, for example, on fruit and veg some retailers make a 38 per cent gross profit, but then you have got stock losses and shrinkage after that, and on dry groceries it's around 18 to 19. But I don't think it's a correct statement to say that they make absolutely – they make no money at all on the groceries that they buy from us.

THE CHAIRMAN: Well, under further interrogation, Mr Cummings appears to stretch the proposition beyond his own Metcash invoices to the industry generally that he represents as the President of the National Association of Retail Grocers Australia, NARGA. He says this – because I said:

> *That's a very important point, Mr Cumming. Thank you for bringing it to my attention, because that's what I was trying to get to. So, therefore, your ability to compete with the major supermarket chains as an independent retailer depends not only on your own efficiency but the cost of supply to you by Metcash are the products of which you're competing other than those that you're buying direct.*

He then responds:

> *No, because Coles and Woolworths do exactly the same. Coles and Woolworths, if we're line ball, if we're lion park –*

I think it must be – I'm not sure if that's lion park or line park –

> *but if we go back to that promise that we're buying at the same –*

Then there was some pretty garbled stuff:

> *We have Vegemite in 525 grams.*

But he went on and said – he said this:

> *In dry goods, dry good groceries, I think it would be fair to say that –*

And then I put in the words:

> *You'd make a loss.*
>
> *In dry good groceries nobody – and that is why Franklins no longer exists because they found they could not make money out of just selling dry goods groceries.*

In a sense it is suggesting then that in dry goods groceries, which is fundamentally what's being purchased from Metcash, the groups that he represents, that is the – what, seven and a half thousand independent groceries, which are members of NARGA, be making a loss. And I'm just trying to understand if Mr Cummings is making it up or he's, you know, telling us fibs or what. Can you help us?

MR REITZER: Commissioner, if that was true across all my retailers, we wouldn't be sitting here today. I wouldn't have a job, Metcash wouldn't exist, and none of them would exist. Our retailers make gross margins similar to what the chains make on the goods they buy from us. We know we benchmark the gross profit reports against the chains. The one valid point he makes that, in retail today, if you don't have a good fresh mix in your supermarket you don't have as profitable a supermarket as one that only sells dry groceries. So if you're only going to focus on dry groceries where the margin is lower and the chains make a lower margins, yes, you'll have a hard time making a profit.

THE CHAIRMAN: What he says - and I won't sort of keep on quoting his comments because there they're on the public record - but what he seems to be saying as we interrogated further was this, because we started off by saying – by asking him – what was the EBIT margin of the independent grocers, and he said, well, it was about three per cent. Then I sort of added that to around the four per cent that we have talked about for Metcash, although you quote publicly an EBITDA margin. But talked about that and it got to seven per cent, and he said, no, no – he said, you don't understand our business case. He said, we – and I'm verballing him a bit at the moment, but I'm just trying to sort of summarise it. He says here that:

> *What effectively is happening is this, is that we are either breaking even or losing money out of the products that we purchase from Metcash, but there's a total business case whereby we make money on the products that we don't purchase from Metcash. And that creates a total store experience. And that's what gives us our three per cent EBIT margin.*

Now, if you worked on a 50:50 structure – and let's just give you the benefit of the doubt that, in fact, they're breaking even on the Metcash sales rather than losing money, which he does suggest here as what's occurring – then what he's really saying is on the non-Metcash items which is the remaining 50 per cent of what's being sold by the seven and a half thousand NARGA representatives that he – or NARGA independent stores that he represents, they're making a three per cent EBIT margin or, effectively, on that 50 per cent, a six per cent EBIT margin, as they must be doing. So I'm just trying to understand – he says:

> *The reason that we deal with Metcash is because we have to have the dry goods groceries to provide a total store experience, but we really make our money on the non-dry goods, and the non – well, to be fair, it's on the non-dry goods and the non-Metcash items that we purchase from elsewhere than Metcash.*

Now, have I got it wrong or has Mr Cummings got it wrong, and he is, after all, representing seven and a half thousand independent grocers?

MR REITZER: Commissioner, what I would like to do is, in a closed session, go through the PwC study which got the – which was based on getting profit and loss reports and verifying them from every single IGA retailer. And that shows a very different picture to the one painted by Mr Cummings.

THE CHAIRMAN: So that study is public, isn't it?

MR REITZER: No, it's not, it's - - -

THE CHAIRMAN: It's not? Okay. Well, would our representative from PwC like to comment in public – in a public hearing without going into the – the confidential elements of that study – on – no?

MR WATSON: No.

MR REITZER: No.

MR WATSON: The information was obtained under strict confidentiality obligations.

THE CHAIRMAN: Okay. I just want to take this one step further, and we'll get on to the role of NARGA and everything else a bit later on I expect, but we have got a survey – it's a public survey by BITRE, which is the Bureau of Infrastructure, Transport and Regional Economics, and they comment upon the price competitiveness issue that Mr O'Donovan has just been talking about. And they say this:

> *Coles and Woolworths –*

I'm reading from a summary of their submission:

> *Coles and Woolworths had very similar prices. On average their prices differ by about one per cent.*

And in previous hearings I have commented upon this and, in fact, asked whether Coles and Woolworths are competing each other, and they say, well, no, it's about one per cent. In fact we have seen chartered material to suggest that there's very little difference between Coles and Woolworths.

MR REITZER: That's correct.

THE CHAIRMAN: Now, the evidence you have so far given this morning is that the independent grocers that are supplied by Metcash generally seek to price at the level of Coles and Woolworths. They don't seek to, you know, dramatically undercut, although there may be instances in certain areas, but they're pricing is set at around the Coles and Woolworths level. So I guess I have got to ask the question that I have asked at a previous hearing, where's the competition?

MR REITZER: Mr Chairman, you're 100 per cent correct. In this highly concentrated industry the two – and we see it because we shop in their stores every single week in every single State – are very, very close to each other. And we build price files for our retailers based on that information, and there are very few that decide on an every day basis to go below them. So the only competition that really applies in this industry is the promotions. And our promotions make up 30 to 40 per cent of our sales, and we have three to 4000 items on promotion at any one week, and that's where the competitive tension is created.

THE CHAIRMAN: But I think you're admitting, are you not, in the evidence you gave before – unless I have misunderstood it – that you're not providing the competition either?

MR REITZER: In terms of promotional programs and promotional pricing for 30 to 40 per cent of the sales, we are providing competitive tension.

THE CHAIRMAN: But weren't you indicating that the pricing of your – I say your – I'm talking about that outlets that you supply – tends to be up to the level of whatever Coles and Woolworths are charging, and Coles and Woolworths have a variation between them, according to the BITRE survey, of about one per cent only. So I'm trying to see where – who's providing the competition. Now, you say Mr McMahon says that it's the Super IGAs, and yet you're telling us that the Super IGAs and all the other IGAs are actually pricing up to the level of Coles and Woolworths. In fact, that, I have to say, does coincide with – does agree with – the information and the evidence given to us by Mr Cummings of NARGA. So we have got agreement on that issue at least.

MR REITZER: Yes.

THE CHAIRMAN: So I'm just trying to understand where the competition is coming from. It's not coming from the independents that you're supplying. It appears not to be coming from Coles or from Woolworths. So who's competing?

MR REITZER: All three participants, independents, Woolworths and Coles, compete and, where it is evidenced in pricing, is on the promotional. So if you compare the promotions that are out there this week or last week, that's where the competition appears. And the two formats of supermarket retailing in the word, the so called EDOP - and Walmart is a past proponent of EDOP – but what you do is you don't have promotions, you roll all that money and all those deals into a flat price 52 weeks of the year. None of the retailers in Australia do that. We're all extreme high/low. So we all have 30 to 40 per cent, 3, 4, 5000 items on promotion each week, and that's where the promotions is.

And, traditionally, every time – definitely in our business, but I think in my competitors business as well - the promotions cost a lot of money, are very difficult to manage, it's very difficult to get your stock availability correct. So every now and again one of us decides let's cut back a little bit on the promotions, and your business suffers. The moment you cut back on the promotions your business suffers. So that's why – that's the only place that I would say that there's competitive tension as far as prices are concerned.

THE CHAIRMAN: Do you think Coles and Woollies are making excessive profits? You know what their EBIT margins are, that's been well publicised.

MR REITZER: Yes, well, unfortunately Coles aren't in the picture because of their problems over the last four or five years. So their EBIT margins are half of what Woolworths EBIT margins. Woolworths are an extremely good operator, and extremely efficient operator. They have invested hundreds of millions of dollars in the supply chain, and it's tough to compete with them to keep your prices as low. I would say that their EBIT margins at the top end in terms of the EBIT margins made by retailers in the world. Would definitely be at the top end.

THE CHAIRMAN: Well, we know that the EBIT margin of Woolworths I think has been disclosed at somewhere in the 5.5 to six per cent mark.

MR REITZER: Commissioner, the only report I have is in their segmental break up and it includes liquor and petrol. And liquor and petrol is a very – is a very – is a much lower margin business than grocery. So I have seen reports were analysts have attempted to take out liquor and petrol. So pure groceries – I think the number was 6.3 or 6.4 per cent EBIT.

THE CHAIRMAN: Yes, I don't think it was quite as high as that, but anyway that – and Coles, I think you say, are running about half that?

MR REITZER: That's correct.

THE CHAIRMAN: Yes.

MR REITZER: According to the reports that I read, so I wouldn't know.

THE CHAIRMAN: Right. And now let's try and put together – I'm doing the same thing as I did with Mr Cumming, I'm sorry, so I'm just trying to – I'm trying to get some understanding about what Mr Cummings told us and what you're telling us, because if I put together your EBITDA margin, which I know has a variation from the EBIT margin, which I think is published at around 4.25 per cent or thereabouts?

MR REITZER: That's EBIT. So just - our EBIT margin is 4.2.

THE CHAIRMAN: Okay. All right. Okay. And then if I take Mr Cumming's comment that the IGAs generally would make about a three per cent EBIT margin.

MR REITZER: Okay. Again, I'm - - -

THE CHAIRMAN: And that's his words.

MR REITZER: Yes, that's – okay, that's his words.

THE CHAIRMAN: Well, I'm just – and, again, we might have to go into some discussion with PwC on the report on that. That's about seven per cent in terms of the total vertically integrated process. Is that a fair comparison, or have I got it wrong?

MR REITZER: Commissioner, it's not 100 per cent accurate. Commissioner, our 4.2 per cent is on our wholesale sales. And our wholesale sales, on average - and with IGA it's a bit higher – but on average it's about 55 per cent of our customers retail sales. So if you're trying to do – which is obviously what we do every day of our lives – is take the Woolworths EBIT margin and make sure and see how that is split between us and our retailers. So you would take our 4.2 and take 55 per cent of that, so it comes to about 2 and a half per cent.

So of the – if we use my numbers, of the 6.3 per cent that Woolworths make in their supermarkets purely on the grocery, excluding liquor and fuel, of the 6.3 per cent Metcash take 2 and a half, which is about a third, 30 to 40 per cent, and the balance is made by retailers. Plus some of our retailers make a little bit more because they have lower costs, or some of our retailers make a little bit more because they decide to sell at slightly higher prices. So the split in our industry is approximately one third, two thirds.

THE CHAIRMAN: All right. Well, we'll have some interesting conversations through the day, but this will – that's a – thank you very much.

MR O'DONOVAN: Right. So when you say it's split one thirds to two thirds, are Metcash getting the one third?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. And, in terms of calculating that if you were a retailer, would you be able to calculate that from looking at your invoices, are you talking only about the published terms which the retailers know about, or are you including in that the confidential rebates and other payments that Metcash get from other sources?

MR REITZER: The way you would calculate that if your were a retailers - you wouldn't be able to see that on your invoices – is to read the published accounts of Metcash - because we're a publicly traded company – seeing what our EBIT is, and expressing that as a percentage of your purchases from Metcash, and then the balance would the profit you'd make, and you would see whether what I'm saying is true or not true.

MR O'DONOVAN: All right. So – now, just – if we go back to 2001/2002, as I understand, the structure of the wholesale market, at least on the east coast, that there were two possible wholesale suppliers, Australian Independent Wholesalers and Metcash, is that right?

MR REITZER: I can’t remember the dates, but I think you’re approximately correct.

MR O'DONOVAN: Okay. And Australian Independent Wholesalers was operated by Woolworths?

MR REITZER: Yes.

MR O'DONOVAN: Okay. So at that point in time the retailers had a choice about which wholesaler they deal with?

MR REITZER: Yes.

MR O'DONOVAN: Okay. And, at that time, just looking historically, the EBITDA percentage margin that IGA distribution, or its equivalent, was earning was about 2.89 per cent? Does that sound right to you?

MR REITZER: It sounds correct.

MR O'DONOVAN: Okay. But that margin, at last year, had risen by one and a half per cent, does that sound right, to four and a half per cent?

MR REITZER: Just under one and a half, yes. 4.2.

MR O'DONOVAN: Right. Okay. So it had – but it had risen just under one and a half per cent?

MR REITZER: Yes.

MR O'DONOVAN: Okay. So in terms of the cents in the consumer dollar that Metcash was getting, it was getting one and a half cents more than it had been five years previous?

MR REITZER: That’s correct.

MR O'DONOVAN: Okay. Now, as I understand it, only half a cent of that was contributed by improvements in cost of doing business?

MR REITZER: I haven’t done that analysis, but I would guess you’re right, yes, half a per cent would come – half of it would come as a result of lower cost of doing business.

MR O'DONOVAN: Yes.

MR REITZER: And half of it would have come as a result of bigger volumes.

MR O'DONOVAN: Just – this is in terms of the percentage margin?

MR REITZER: Yes.

MR O'DONOVAN: So can you – now, how can – can you tell me how it is that increased volumes would have increased your percentage margin on sales?

MR REITZER: Because our basic infrastructure in 2001 was there and, as we managed to grow the volume, we didn't have to increase our overheads significantly. So the costs that make up all your overhead – or what we would call our fixed costs – don't increase when your volume increases that much. All that you have to add is more labour and maybe, you know, more forklifts and things like that, so it's your variable costs that go up. So that's why, when your volume goes up, a big part of the volume contributes to the extra profit because your fixed overheads are covered. And the other part goes up because you use technology, and systems, and incentives, and workplace reforms to make your productivity higher. So that gives you the second part of the profits.

MR O'DONOVAN: Okay. So at the moment we're looking at the ration of total sales?

MR REITZER: Yes.

MR O'DONOVAN: And then cost of doing business as a percentage is taken out?

MR REITZER: Yes.

MR O'DONOVAN: Okay. And then from the - cost of sales is taken out. So whatever you paid for the goods. And then cost of doing business is taken out, and that leaves a – we're dealing only here with percentages, okay?

MR REITZER: Yes.

MR O'DONOVAN: So it's the case, isn't it, that increases in volumes won't show up as a higher percentage margin? They might show up as a higher dollar figure. Your earnings might, as a matter of fact, be higher, but it won't show up as a bigger percentage earnings for you?

MR REITZER: No, I beg your pardon, yes, it will definitely.

MR O'DONOVAN: So you say that the extra one per cent which, effectively, is the difference between what you're earning now in 2006/7 as opposed to '01/02, that's not Metcash increasing its margin, that's just Metcash increasing its volume?

MR REITZER: It's a combination of increased productivity. So the return you get on your variable cost is higher, and sweating the assets harder, so you have got to warehouse. And those are the two things, and they make the dollars that you bank, your EBIT dollars, bigger. And when you divide those EBIT dollars into your turnover it's a higher percentage. It affects both the dollars and the percentage.

MR O'DONOVAN: Right.

MR WATSON: Mr O'Donovan, I think it's critical to remember here that during the time periods you're talking Metcash has doubled its sales. This is not a question of small increment. This is an actual, you know, doubling of the sales.

MR REITZER: And we didn't double our warehouses. So you just push more boxes through a similar warehouse infrastructure.

MR O'DONOVAN: All right. But – so you wouldn't accept that that one per cent improvement in your EBIT percentage represents in any way Metcash taking a bigger margin?

MR REITZER: It does represent Metcash taking a bigger margin because, if you look at the overall profitability in the industry in the year 2000, and if you specifically look at my competitor that sets that profitability, Woolworths determine how much profit there is on the table for the independent retailers and Metcash to share. And back in the year 2000 - and that's the competitive tension that I referred to that gets created at retail – so back in 2000 I can't remember what EBIT Woolworths were operating at in their grocery, but I think it was half of what it is now as well. And that was the profit pool, if you want, that was available for the independent retailers and Metcash to share. Now it's doubled.

MR O'DONOVAN: All right. So you have effectively followed your – your network has followed Woolworths up - - -

MR REITZER: Yes.

MR O'DONOVAN: - - - in terms of the margin that you make.

MR REITZER: That's correct.

MR O'DONOVAN: And your margin, as the wholesaler, has improved, and you have captured one per cent of that improved margin?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. So it's true to say that consumers are now paying Metcash 1 cent in every dollar more than they were paying to Metcash five years ago?

MR REITZER: No, that – the last part is incorrect because we have earned that just as Woolworths has as a result of greater productivity, reducing our cost of doing business, and sweating our assets harder, working our fixed assets harder. That's why we're getting the extra 1 cent in the dollar.

MR O'DONOVAN: Okay. So why then, if it's just you performing better internally, why then is the fact that Woolworths has pushed out its margins at all relevant to what margins you're making?

MR REITZER: Because that's what's available in our industry. So if you have a model where you work as hard you possibly can to get your costs as low as possible on the distribution and the running of the retail store, and you join banner groups, and you create buying power in the brands to get the costs of goods in your promotions as good as possible, and then you go out and monitor your opposition. And, as the Commissioner said, you can't afford to sell, you know, lower than them, but it's more or less at their price. If their margin goes up so does the margin go up in your sector of the industry. That's how it works.

MR O'DONOVAN: Okay. And so, in that sense, a lack of competition in the retail sector has not caused – sorry, as a consequence of – there's been not enough competition in the sector either from you or from Woolworths to shrink that margin back down to what it was three years ago?

MR REITZER: That's absolutely correct. If something happened tomorrow and Woolworths made a decision to make half the EBIT that they're making today, our EBIT, as Metcash the wholesaler, would half and so would our retailers.

MR O'DONOVAN: Sure. Right. But Metcash is not going - - -

MR REITZER: That's what happens in a free market, yes.

MR O'DONOVAN: Sure. And Metcash certainly isn't going to make a decision to half its margins to increase volume?

MR REITZER: Halving our margins wouldn't increase volume. I mean, there's other things that one employs as a retailer and a wholesaler to increase your volume. So that wouldn't – and, no, we wouldn't make a decision like that on our own.

MR O'DONOVAN: All right. Shall we take - - -

THE CHAIRMAN: Yes, I just want to take this – I'm sorry, just to burrow just a little bit further because you made a comment just then, and I haven't got the exact words and, unfortunately, we can't read the transcript, but I think you said something like, that Coles and Woolworths will set a price, and we have already got BITRE that's saying there's barely a one per cent differential between them, and that you and your customers, that is your retailers, will match that price. And if Coles and Woolworths push up their price then your customers, your retailers, will lift their price accordingly and that will increase the margin. If they drop the price then obviously they have to drop accordingly. So this is a matching game, isn't it? It's not a truly competitive game. This is matching the price rather than trying to drive the competition or drive the price down?

MR REITZER: That's correct.

THE CHAIRMAN: Yes.

MR REITZER: Especially, Commissioner, on every day prices. Not so much on the promotions, because there there's a bit of cutting and going 10 cents and roll back, and two for one and everything like that, but on every day prices that's correct.

THE CHAIRMAN: Yes. Which really suggests – and what I'm trying to get to is to the competitive dynamic that we're dealing with here, because if BITRE are correct, and we do have information that suggests that they are correct, that if you look at the lines on the chart between Coles and Woolworths they're so close together it's barely discernable to show the difference in pricing. And if we then take the evidence that you have just given, and Mr Cumnings gave us, which is that the independent sector actually prices up to Coles and Woolworths, you have almost got a straight line, haven't you, running right through. There's hardly any – I'm trying to find out where the competitive pressure is coming from.

Now, Mr Cummings says, we, the independent sector are the ones that keep the majors honest, and we're the ones that provide the real competition. I don't think that's right, is it? I don't think your – I think you're suggesting that's not the case. That, in fact, you're sitting there comfortably just at the Coles and Woolworths price.

MR REITZER: Commissioner, the impact of promotions has a very large part to play in Australia, and if we were all EDOP retailers what you're saying would be 100 per cent correct, but 30 to 40 per cent of our sales are on promotion, and that's what rates as the competitive tension. So one of the retailers, for example, started doing a lot of multi-buy. So if you get two for the price of one, and things like that, that raises extremely high competitive tension in the industry because everyone reacts to that and everyone tries to add that. So it's really the promotions, and the catalogues, and the specials, and I think one of my competitor used a program called roll back. Those are all the promotions that create tremendous competitive tension. But the every day price on the shelf, you would be correct in saying that that's one of matching.

THE CHAIRMAN: Which leads to, as you have described it – I don't think these are exactly your words – but world class EBIT margins by those operating in this industry?

MR REITZER: By one of our competitors, yes, at the top end.

THE CHAIRMAN: That's the top end. That's Woolworths.

MR REITZER: Yes.

THE CHAIRMAN: But, in fact, the combine EBIT margins of Metcash - - -

MR REITZER: The independents.

THE CHAIRMAN: - - - and I'm using Mr Cumming's assessment, a three per cent EBIT margins for your customers. So that seven per cent seems to be higher than Woolworths. So that's even better still.

MR REITZER: Yes.

THE CHAIRMAN: Yes. It's a very profitable business, isn't it, that is resulting from lack of competition?

MR REITZER: I don't necessarily know that seven is lack of competition because, I mean, our perception is it is fiercely competitive and there are many retailers and stores that fail.

THE CHAIRMAN: When you say it's fiercely competitive, who's competing?

MR REITZER: On promotions, well, at the moment, two of us, and the third player.

THE CHAIRMAN: And yet the combined EBIT margins, unless I'm totally mistaken, the combined EBIT margins of a vertically integrated Metcash and its IGA outlets is sitting at around seven per cent plus. I'm using Mr Cumming's three per cent. Maybe higher. We'll find out from PwC when we go into closed session. But it's sitting around seven per cent. You have described the Woolworths number of something around the five and a half to six per cent as being world class. That's my word, sorry, I think. I forget the word you used, but world class. You have said Coles have got some difficulty because of – difficulties over the past two or three years.

But that's showing a highly profitable industry where – I'm trying to – I'm at a loss to try and find where the competitive tension is coming from. It's certainly not coming from the independent sector because the independent sector, you have said to me, are really matching on every day items, are matching the price of Coles and Woolworths.

MR REITZER: On every day shelf prices, yes, because with the power that the chains have on every day shelf prices that's the best some of our retailers can do. Many of them do go below that. But what I'm trying to explain is that it's the promotional content of our sales and our programs that add the competitive tension. So every week in everyone's letter box in Australia there are three catalogues with offers and, specials, and discounts, and buy two of these for the price of one, etcetera. That's where the competitive tension happens. And if there are two players in a market the level of promotions, and the levels of specials, and how deep cut those promotions, are less than if they're three and less if there's four or five. That's what naturally happens. The more promotions, the more catalogues. And that's what all the competitors react to.

So if you have an IGA store and you just have one chain store in your area, that's the – you react to their promotions. If you then also get an ALDI catalogue, and you get a Coles catalogue, and some of the other discounters are also selling food products in your promotional program you react to all of those, and that level – that raises the level of competition.

THE CHAIRMAN: And with that raised level of competition you can achieve a combined – I'll say vertically combined – EBIT margin of seven per cent which is better than that of the world class Woolworths.

MR REITZER: In highly competitive – I think Woolworths is closer to six, but in highly - - -

THE CHAIRMAN: I'll concede that Woolworths is somewhere between five and a half and six, but it's that sort of order, yes.

MR REITZER: I think I'm correct in saying that the EBIT margins of the chains are not the same at every single branch. Just like the EBIT margins within IGA, I know for sure, are not the same at every single branch. We have retailers running at a one per cent EBIT, we have retailers running at a five and a four per cent EBIT. Mr Cummings says he operates at a three per cent EBIT. That is driven by the level of competition in that area.

And, for example, we have a retailer in the western suburbs of Sydney that's just decided to be cheaper than everyone. He does enormous volumes at an extremely low EBIT, but that's – he banks big dollars. So he's happy to do that. And the competitive tension there – I think there are six chain stores and four ALDIs in, like, a 20 minute drive from his store. So that's a competitive hot bed. And what adds the competition there is number one, lower shelf prices, but I think that's changing, and very aggressive promotions.

THE CHAIRMAN: All right. You wanted to take a break, Mr O'Donovan?

MR O'DONOVAN: Yes.

THE CHAIRMAN: All right. We'll take a break and come back at – how long do you want?

MR O'DONOVAN: Just 10 minutes.

THE CHAIRMAN: 10 minutes. Thanks.

ADJOURNED **[11.19 am]**

RESUMED **[11.32 am]**

THE CHAIRMAN: Well, I can say to you, Mr Reitzer, that you've performed equally as well as your predecessors in this hearing – that is Mr Luscombe and Mr McMahon – and that is you've caused a run on the biscuits, they've all gone. And we will have to consult your wholesale division about getting further supplies. All right. I will hand over to Mr O'Donovan.

MR O'DONOVAN: Now, looking at the provision of wholesale services, firstly just from our previous discussion there does appear to be scope for lower margins at the wholesale level if there was a wholesale competitor in relation to Metcash. Would you agree with that proposition?

MR REITZER: If they could do things cheaper and better than us, then they would be able to operate at a lower margin, and then we would have to match them, yes.

MR O'DONOVAN: Sure, but even if they could do things exactly the same, they could also deliver to customers goods at a lower margin?

MR REITZER: I suppose they could, yes.

MR O'DONOVAN: All right. So it's possible that there might be an improvement in the independent sector in terms of its price competitiveness if there was a competitive wholesaler introduced to – to compete against Metcash?

MR REITZER: Yes, the barriers to entry in terms of wholesale distribution are quite low, as was evidenced by the Franklins case. They went to a transport company. They had a spare warehouse, and they set up a warehouse with them very very quickly, and obviously very very cheaply. And so it's not, like, difficult to get a warehouse in Australia; it's not difficult to get the trucks, the technology. Everyone knows exactly what technology we use. You just buy it off the shelf. We don't have a technology. So they would be able to set up a warehouse. The big question is how much volume they can pump through it.

MR O'DONOVAN: Sure. But one of the difficulties that your customers have also is that they're not – that it's not transparent how much value Metcash actually gets out of their particular volumes. Would you agree with that proposition?

MR REITZER: You mean one particular store?

MR O'DONOVAN: No, no. Well, let's take a Franklins. Franklins was unsure how much revenue their volumes were generating for you.

MR REITZER: No, they knew exactly how much volume they would generate because they had to pay their account every week.

MR O'DONOVAN: Sure. So they were - but as we discussed before, there were confidential terms, the value of which they did not know.

MR REITZER: No, they knew the value of the confidential terms because we told them; the warehouse confidential terms, we told them to the second decimal place. And they knew the value of the profit that we were making because it was shown – I don't know if it was shown – it was shown on every single invoice I think, and the profit that we had made on their account.

MR O'DONOVAN: All right. So that's including the confidential terms which you could – only you could get as a warehouse operator?

MR REITZER: That was in addition to the margin that we charged them on every single invoice.

MR O'DONOVAN: So are you telling me that you did disclose to Franklins how much you made on the confidential terms that you – only Franklins – sorry, only Metcash could earn as a warehouse operator?

MR REITZER: Yes.

MR O'DONOVAN: Right. So why then in the court case which you ran did you oppose any order that would have permitted Franklins access to the materials that would have allowed them to assess what the value of those confidential terms were?

MR REITZER: Can I please discuss that in a closed session?

MR O'DONOVAN: Well, it's on – it's a public – it's on the public record, the decision is on the public records and the question - - -

MR WATSON: Yes, but, Mr O'Donovan, what you must appreciate though is that the matter is currently going to be appealed, and any answers that we may give to that level of detailed questioning may well impact on the future conduct of that litigation, as I mentioned earlier.

MR O'DONOVAN: All right. Well - - -

MR WATSON: I mean, the submissions for the appeal haven't even been lodged yet so we couldn't possibly answer that in a public arena.

MR O'DONOVAN: Well, then can I just confirm that you stand by your evidence that Franklins knew all of the money that you were making out of their volumes?

MR REITZER: Yes.

MR O'DONOVAN: They knew that?

MR REITZER: Yes.

MR O'DONOVAN: Okay, all right. Now, in relation to, say, an existing client like FoodWorks, would they have knowledge of all of the money that Metcash makes out of its volumes to the cent?

MR REITZER: No.

MR O'DONOVAN: No, okay. And part of the reason for that is that there's not – that the way in which Metcash structures its supply terms is that there are these all different kinds of rebates, some of which are placed on the invoice, many of which simply don't appear on the invoice.

MR REITZER: I think I need to draw a differentiation in how the warehouse supply contract that you offer to Franklins and the one that we do for everyone else. In terms of organisations such as IGA retailers or FoodWorks retailers, in terms of the boxes that move through the warehouse and the price at which those goods are invoiced to the retailer, it's exactly the same. So we take off all the published discounts, or case discounts, trade discounts, and any case deal. And in the case of FoodWorks, they negotiate their own promotional deals and then pass them – tell us and we deduct them and pass them through to there.

In the case of FoodWorks, we negotiate all the confidential terms with manufactures which we don't tell them about. It's confidential between us and each manufacturer. We collect all of those and out of that pool we pay them a flat – yes, it's a flat rebate, a percentage of their purchases which is also confidential, please. So in terms of your question, do they know for every single manufacturer what our confidential terms are, no, those are confidential between us and our retailers. But what we do is we lump them up, and then we pay a portion of that over to FoodWorks.

MR O'DONOVAN: Okay. So from the perspective of someone who was looking to see whether there are more cost efficient ways of getting their wholesale supplies, they are actually not in a position to work out whether or not the terms that they're getting from Metcash are good, bad, or indifferent as compared to their other options. Is that the case?

MR REITZER: I think you're correct in terms of being unable to work it out in an item level, because the rebate I pay them is a flat rebate. So they can't take an item and say, you know, here's coffee, is it cheaper to buy it somewhere else? Because when they come to the confidential terms, they just get X percentage. Whereas for coffee it might be a little bit higher or might be a little bit lower. But what they can definitely do as an organisation is say, here's an alternative supply chain, let's set up our own warehouse and let's go to A or L, let's go to Franklins, and they would get a deal from anyone of those sources that they can compare directly to us to, to the last cent.

MR O'DONOVAN: They can do that?

MR REITZER: Yes.

MR O'DONOVAN: All right. Well, we've been provided with a list of I think 33 separate rebates and allowances and pick fees which are a possible for Metcash to charge. Is it that kind of number that the variety of rebates that Metcash negotiates with its suppliers?

MR REITZER: I know it's a lot. I wouldn't be able to say if it's 33 but, yes, it's a lot.

MR O'DONOVAN: Okay. No, no, I am – what I might do is just go through all of these rebates and just try and understand what is their purpose, and what's the – whether or not they're confidential and known to your customers, or whether they are confidential terms which Metcash retains.

MR REITZER: Between us and the manufacturer, yes.

MR O'DONOVAN: Yes, okay. So an AAW rebate, what's that for?

MR REITZER: That's confidential.

MR O'DONOVAN: Okay, and what does AAW stand for?

MR REITZER: AAW was a buying group that we set up with Foodland when Foodland was a separate wholesaler in Western Australia. We used to buy corporate brands together. So if it was Metcash – all the old Davids used to go on the eastern seaboard and South Australia, and Foodland was in Perth. And we set up an organisation called AAW and I can't remember what it stands for. Australian Associated Wholesalers.

MR O'DONOVAN: Okay.

MR REITZER: And I think prior to that when there used to be ten wholesalers in Australia, they formed it. But it ended up just being Foodland and ourselves, and it was a confidential rebate that was negotiated primarily I think on branded – on house brands, but I think it could have applied to some branded goods as well, for joint execution of programs. When we acquired Foodland two years ago about, it just got rolled into the term. So it's just their names, so that's what it arose from.

MR O'DONOVAN: All right. And so that's a confidential rebate, and a rebate that is retained entirely at the Metcash level and not passed through in lower prices to the store owners?

MR REITZER: Yes.

MR O'DONOVAN: Yes, okay. The bonus stock claims; is that confidential or would that appear on the invoice?

MR REITZER: It's definitely confidential, but it's – I would have to see a manufacturer that you're referring to, and I could do that in confidence to tell you whether it is or isn't passed through. There are some bonus stock claims which is just like, you know, buy ten get one free. And for certain suppliers I think that gets passed through so I would have to check – I would need a specific of the supplier, and then I could go and check for you.

MR O'DONOVAN: Sure. Bonus stock pick fees?

MR REITZER: I have no idea what that is.

MR O'DONOVAN: Okay. Centralisation rebate?

MR REITZER: It's confidential.

MR O'DONOVAN: So again not passed through to the store?

MR REITZER: No.

MR O'DONOVAN: No. Channel advertising allowance?

MR REITZER: That's confidential.

MR O'DONOVAN: Charge through allowance?

MR REITZER: In different states I can – a charge through allowance is where the goods go directly to the store but the paperwork comes through Metcash.

MR O'DONOVAN: Right.

MR REITZER: So in certain cases, for example, things like bread, it is just impossible to channel it through a distribution centre, and our competitors don't do it either. So the goods go directly to the store but we pay the manufacturer. So the manufacturer is sure about the – he doesn't have to worry about his debt. He just sends us one invoice, one statement, and there are certain benefits to that. In some states a portion of the charge through allowance is passed back to the retailers. It's different by states, but that is definitely confidential. But in some states, if I recall correctly, some of it does get passed through to the retailer.

MR O'DONOVAN: Okay. The container de-vanning fees?

MR REITZER: That would be confidential, and that would not be passed – would not be passed through.

MR O'DONOVAN: Okay. Co-op promotional allowance?

MR REITZER: That's confidential.

MR O'DONOVAN: Corporate brands rebate?

MR REITZER: That's confidential.

MR O'DONOVAN: Cross-stocking allowance?

MR REITZER: Confidential.

MR O'DONOVAN: Data rebate?

MR REITZER: That's confidential and doesn't fall into what I spoke about before, that falls into – so that's where we sell our information, not our retailers information, our information to organisations like ACNielsen. They pay for it but that gets shown on a different income line on our profit and loss.

MR O'DONOVAN: Sure. Early payment discount?

MR REITZER: Is confidential.

MR O'DONOVAN: House brand generic rebates?

MR REITZER: Is confidential.

MR O'DONOVAN: Incentive rebate?

MR REITZER: I think the majority of them are confidential. There could be some that get passed through, but the majority of them are confidential.

MR O'DONOVAN: Okay. Introductor partnership rebate?

MR REITZER: I don't know what that is, sorry.

MR O'DONOVAN: Okay. National rebates?

MR REITZER: Are confidential.

MR O'DONOVAN: New line fees?

MR REITZER: Are confidential.

MR O'DONOVAN: Over and above allowance?

MR REITZER: That's confidential.

MR O'DONOVAN: Quantity buy allowance?

MR REITZER: Is in the published terms – is passed through on the invoice.

MR O'DONOVAN: Okay. Redistribution allowance?

MR REITZER: Is confidential.

MR O'DONOVAN: RMS rebate?

MR REITZER: For certain product categories we provide a service to the retailer where we for those retailers that want it go and merchandise in their store. So, for example, general merchandise is a very difficult thing to merchandise and we have teams going around to our retailers that want it, and we actually pack the shelves and make the order for the next thing. And the manufacturers that are on that program – it is called the RMS program – pay us for that. So that doesn't go into that pool that I spoke about. It goes towards the salaries and wages of those people that provide that service.

MR O'DONOVAN: Okay. So does it appear on – but it doesn't appear on the invoice?

MR REITZER: No, no, not on the invoice.

MR O'DONOVAN: Okay. Service fee?

MR REITZER: Is added to every invoice that we charge a retailer.

MR O'DONOVAN: Okay, and that's effectively the fee for providing warehouse services?

MR REITZER: That's not from the manufacturer – yes, that's not from the manufacturer to us, that's from us to the retailer.

MR O'DONOVAN: Yes, okay. Settlement discount?

MR REITZER: Is passed through in the price of goods.

MR O'DONOVAN: Shelf management rebate?

MR REITZER: I'm not a hundred per cent sure what that is. I think I know what it is but I will have to check and come back, but it's confidential and – but not into that same pool of income.

MR O'DONOVAN: Okay. Slow moving warehouse allowance?

MR REITZER: Is confidential.

MR O'DONOVAN: Special events rebate?

MR REITZER: Is confidential.

MR O'DONOVAN: State rebates?

MR REITZER: Confidential.

MR O'DONOVAN: Storage fees?

MR REITZER: No idea what that is.

MR O'DONOVAN: Okay. Ullage allowance?

MR REITZER: Ullage is passed through partially to the retailer.

MR O'DONOVAN: Under bond allowance?

MR REITZER: It relates to our liquor business only.

MR O'DONOVAN: UVW rebate?

MR REITZER: That's the same as AAW. It's confidential and it applies only to general merchandise.

MR O'DONOVAN: Warehouse efficiency rebate?

MR REITZER: It's confidential.

MR O'DONOVAN: Okay. Warehouse trade discount?

MR REITZER: It's confidential.

MR O'DONOVAN: Okay. So out of 33 possible rebates which you can negotiate with the retailer, it seems that only a portion of these are actually passed through.

MR REITZER: That's negotiated with a manufacturer, I beg your pardon.

MR O'DONOVAN: Sure.

MR REITZER: There are other discounts that you haven't mentioned that I passed through to the retailer.

MR O'DONOVAN: Sure, and they're the ones that appear on the invoice?

MR REITZER: Sometimes, yes.

MR O'DONOVAN: Yes, okay. So from Metcash's point of view, if it wants to improve its margin it would focus negotiations on these kinds of rebates, whereas if it wants to improve competitiveness at the retail level it focuses on the other kinds of rebates?

MR REITZER: No, that's not correct. If we want to improve our effective competitiveness or our profits, we would have to negotiate both harder.

MR O'DONOVAN: All right. Now, from the point of view of a retailer, again trying to work out whether or not they can cost effectively switch to another wholesale supplier or another warehousing arrangement, given the number of confidential rebates that Metcash is taking which aren't disclosed to the retailer, how is it possible for them to make any meaningful comparison between the service and price that they are actually paying Metcash, and the costs and benefits of switching to an alternative?

MR REITZER: Because we all work in a similar way. So I'm not aware of the ARRL details but if I was a retailer I would know what I pay for my invoices, so I would take a month's worth of invoices and say, look, this is what I bought from Metcash for a month, give me your prices on those invoices, how much service fee are you going to charge me, I want six deliveries Monday to Saturday at 10 o'clock sharp at my door; I pay Metcash ten days credit; How much credit terms are you prepared to give me, and what's my rebate; and what are the marketing programs and the promotions and the marketing behind that? And I would get an offer I presume from the competitor and compare them. It's quite easy.

What you couldn't do is for the confidentialities work out either from my competitors, because they're also confidential for them, how much of that overall flat rebate that you get applies to coffee, and is it more than Metcash is – because you could - in fact, you're getting a flat rebate on all your purchases. So it's quite an easy comparison.

MR O'DONOVAN: Right. So you think it – so would it be fair to say that it is difficult, or at least the pricing is not transparent so that it makes it difficult to compare the costs of bringing on your own warehousing function; would you agree with that?

MR REITZER: No. The pricing is totally transparent.

MR O'DONOVAN: All right. Well if the pricing is totally transparent, why are there so many confidential rebates?

MR REITZER: Because that's how we collect money from manufacturers to be able to compete with Woolworths and Coles.

MR O'DONOVAN: Okay. Then why is it necessary to do it in a confidential fashion and not in a way where your customers actually understand the benefits that you derive from their volumes?

MR REITZER: Because those are confidential terms all over the world within this industry between the retailer and the wholesaler, and they don't tell – manufacturers don't come in and tell me what confidential terms they give Woolworths or Coles.

I'd love them to, but they're not, they're confidential. And we negotiate ourselves. Please understand that, you know, we are trying to add competitive tension, and I think we do a good job in the Australian market. And we do not have 44 per cent market share. We do not have 33 per cent market share. So we can't sit across from manufacturers and smash the table, and say give me more.

And what we have to do is be innovative, creative, come up with all sorts of programs and all sorts of benefits that take costs out of the supply chain for the manufacturer, and ask to be rewarded for it. Those are all confidential. I can't make them public. I'm sure, I'm absolutely sure, just like I would, that Woolworths and Coles would love to know what my confidential terms are. I'd love to know what theirs are, but in this industry they're not. So they're all lumped into a big cloud and this distributed accordingly. They do exactly the same as we do.

MR O'DONOVAN: All right. But from looking at it, I'm not asking you to disclose it to Coles or Woolworths, but in terms of if you were to price your products with all of these rebates actually accounted for so the cost to Metcash - - -

MR REITZER: Yes.

MR O'DONOVAN: - - - with a per cent on top, that would be easier for your customers to understand, wouldn't it?

MR REITZER: No, you can't do that because then the competition would know what you're confidential terms are the next day.

MR O'DONOVAN: Even if you made it confidential between your customers?

MR REITZER: We produce thousands of invoice very day, please understand. So I mean if everything was on the invoice, they would be on the Coles and Woolworths desk the next day. You can't do that.

MR O'DONOVAN: All right. But there's no other way of conveying this information to your customers without putting it on the invoice?

MR REITZER: No.

MR O'DONOVAN: All right.

MR REITZER: There's also never, up until today, have I heard anyone raise it as an issue so - - -

MR O'DONOVAN: A lack of transparency in pricing?

MR REITZER: For the confidential terms?

MR O'DONOVAN: Yes. You don't think Franklins raised it as an issue?

MR REITZER: No. No, for the - - -

MR O'DONOVAN: They went to court to get access to understand your confidential terms.

MR REITZER: For the four - - -

MR O'DONOVAN: You don't think that was raising it as an issue?

MR REITZER: Afterwards, yes. But for the four years that they were my customer, just like IGA, they understood exactly how we charged them. On two or three occasions they asked an external auditor to verify our strip net cost pricing, and they got certificates from the auditor. They checked thousands of suppliers and items, and they got certificates from the auditors during those four years to verify pricing, and we were found to be – to do it a hundred per cent correctly. And there could be human error in there, but they never found any.

On a number of occasions other retailers have approached us and said, there is something wrong with the strip net costs. We said, like what? And they would say something to us, they would give us an example of a discount or something that's not true. And we said, okay, sign this confidentiality agreement, please. And they've come and checked on us, and found us to be absolutely clear. So they understand the transparency, and the pricing is there. On terms of the confidential trading terms, they're confidential.

MR O'DONOVAN: All right. Well, in relation to – I mean, we've obtained from you some details of settlements you've had with FoodWorks in relation to disputes you've had with FoodWorks and on at least two occasions it's been a condition of the settlement or it's been part of the settlement that FoodWorks won't ask for an audit of these terms.

MR WATSON: I think again, Damien, they're confidential matters that we'd have to answer in closed session. We have confidentiality obligations in those documents we've referred to before so it's not something we could public discuss.

MR O'DONOVAN: So you can't make any comment on whether or not you have had disputes about – so let's go back to your original statement, that you've never had any person raise an issue of transparency in relation to your pricing before?

MR REITZER: Our confidential terms?

MR O'DONOVAN: Yes.

MR REITZER: Yes.

MR O'DONOVAN: And do you stand by that notwithstanding that on the documents that we have it appears it was an issue between yourself and FoodWorks?

MR REITZER: I can't recall an issue between ourselves and FoodWorks on our confidential terms. I'm afraid I can't recall. We've had a number of disputes with FoodWorks but I can't recall, I'm afraid. If there was one, then it's obviously correct, but I just can't recall.

MR O'DONOVAN: All right. And you wouldn't describe the dispute you had with Franklins as originating from a lack of transparency in the pricing that you engage in?

MR REITZER: Can we please go through the Franklins case in a closed session?

MR O'DONOVAN: Sure. All right.

THE CHAIRMAN: Well, there are certain elements of the Franklins that are not closed though, aren't there? And I presume that you've read the evidence given in public hearing by Mr Zelinski when he said this:

> *Franklins tried to establish itself as a third chain in New South Wales. In order to be successful, one would have to compete with Woolworths and Coles on price amongst other things, that being the most important. And the arrangement with Metcash at the time did not leave us with sufficient margin to compete equally with Coles and Woolworths.*

He goes on says:

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

And then he goes on and says:

> *I can only talk from our experience. We were not competitive while we were with Metcash. And I think if we had remained with Metcash we might have had a very different model of a convenience business today as opposed to a third supermarket chain.*

I tried to sum up his evidence just by saying this:

> *Just to test that one step further – and I think Dr King has a question – what that's implying is, correct me if I'm wrong, but what that's implying is that you've been able to establish your own vertically integrated wholesaler*

distribution operation and to deal with suppliers on terms and conditions which give you a better financial return than utilising the wholesale and distribution arrangements offered by Metcash. Is that correct?

Mr Zelinski's response was:

Absolutely correct.

Now, that's all on the public record. Do you want to comment on that?

MR REITZER: We tried our absolute best to help Franklins establish a chain in Australia. We knew them as retailers. I personally knew them as retailers from South Africa where they run a very very successful retail chain. Against the better – against the better judgment of our board, I gave them a sweetheart deal. It had a very low margin in that it was a cost recovery deal with a very low margin and – because they insisted that they would collect all their trading terms and all their confidential discounts and all their promotional discounts themselves. And the margin I made was about a quarter of the margin that I would make on FoodWorks and IGA customers, and then after year one it goes up, and in year two and three it goes up.

We tried our absolute best, and on a number of occasions they wanted to come and check out the transparency of the pricing that we were meant to charge them. They came – the auditors came and checked, and we – and, unfortunately, the business was not a success. I mean, when they left us they sued us – and which I'd like to discuss in greater detail in camera. If I look at their track record post that, I don't think the things Mr Zelinski says are correct because if we were taking such substantial discounts and not passing them on to them, and pocketing them in our pocket, our profits would have dropped dramatically when they left; and they profits would have gone up dramatically when they left. And neither of those things happened.

THE CHAIRMAN: Well, the difficulty I've got – and we've had some difficulty in reconciling some evidence given by Mr Cummings before – but the difficulty I've got is that they sum up that "sweetheart deal", which is the expression you've given to it, as:

The arrangement with Metcash at the time did not leave us with sufficient margin to compete equally with Coles and Woolworths.

Or to use the words that I used is that:

You've been able to establish your own vertically integrated wholesale and distribution operation and deal with suppliers in terms and conditions that give you a better financial return than utilising the wholesale and distribution arrangements offered by Metcash.

Now, that would suggest that the sweetheart deal you've offered them wasn't really sweet, nor close to heart.

MR REITZER: It was a sweetheart deal by my definition because it didn’t give me the same return that I got out of other retailers that are very profitable.

THE CHAIRMAN: And then Mr Zelinski went on in his public evidence to suggest that the structure he has now got – that is the vertically integrated wholesale and distribution operation that he now operates, dealing with suppliers on his own terms and conditions actually enables him to make a profit. Or is he not telling us the truth?

MR REITZER: Commissioner, I can’t comment there, I don’t know if he is or isn’t making a profit. It’s not what I read in the newspapers.

THE CHAIRMAN: Well, I can – we could perhaps pull that transcript evidence out and we can – but my understanding is, my recollection is that he indicated at the time that he was now making a profit. And, indeed, what he also indicated is that he’s got previous customers of Metcash that have moved from Metcash into the Franklins model, had branded themselves Franklins, and seemed to be operating on a more profitable basis. But maybe I’ve got it – I’ve recollected incorrectly.

MR O’DONOVAN: That’s correct.

THE CHAIRMAN: That’s correct, Mr O’Donovan? Thank you.

MR REITZER: Mr Chairman, it’s a competitive market out there. If independent retailers feel that IGA and IGA distribution do a lousy job with us, they leave and they will join FoodWorks or Franklins or ARLL, and it works the other way as well. So I mean if there are independent retailers that have left us and joined Franklins and they’re making a hell of a lot more money than when they were our customers, well done. We have evidence to the opposite so – but that’s – we’re all out there competing with our service and our offerings for the support of independent retailers.

THE CHAIRMAN: Well, we will test it a bit later on just how free they are to leave and to move a Franklins or to a separate collective buying arrangement but – Mr O’Donovan.

MR O’DONOVAN: All right. We might then move to the terms on which supplies are supplied by Metcash, so your generic supply agreement.

MR WATSON: Do you mean retailers?

MR REITZER: Retailers, yes.

MR O'DONOVAN: Yes, retailers. It’s document one in the folder. And if I can just take you to clause 3.5. All right. As I understand that, the meaning of that clause is that, effectively, if Metcash lists a product, anyone who’s buying from Metcash can’t buy it from either direct from the supplier or from anyone else. That they have to buy it from Metcash, is that right?

MR REITZER: Anyone that signed a supply agreement, yes.

MR O'DONOVAN: Yes. Now, who would supply – who would sign the supply agreement?

MR REITZER: Traditionally supply agreements - and they don't always end up like this – but this is like the template and each one gets negotiated because each one is a negotiation with an independent business person – supply agreements are only put in place where we are asked to help the retailer. If I could give you two examples. One is a retailer might be going into a new store where the landlord refuses to accept the retailer as the tenant and he wants Metcash with a blue chip balance sheet as the tenant. So Metcash would sign the head lease for, let's say, 15 years or 20 years, and then sublet to the retailer. Because of the financial exposure of Metcash we would then ask the retailer to please sign a supply agreement and that he will buy from us for the term of that lease. So it goes back to back with the lease.

Your definition of the clause is correct except there's a ..... So price service and quality being the same. So if the retailer can get better service, cheaper price or improved quality then they go – they buy somewhere else. A second example might be where a retailer asks us to lend money. So they approach us and, for one of a variety of reasons, they want to lend money from us. We then say that's okay, but as long as there's a balance owing on that loan account we would require a supply agreement in place with the same .....

MR O'DONOVAN: Okay. So - - -

MR WATSON: Mr O'Donovan, can I just add one point as well, which is that we produced this document under a confidentiality request, so if we're going to drill into the detail of it perhaps it might be something that we look to do in camera.

MR O'DONOVAN: Okay. So this document is not publicly available?

MR WATSON: Correct.

MR O'DONOVAN: All right. What I might – I might leave that. Well, one further question. How many of your current stores have confidentiality agreements of this – have supply agreements of this kind? What sort of proportion are we talking about?

MR REITZER: If I said a percentage it would be a wild guess. Can I take that and come back to the Commissioner with the exact number? Any number that I mention, I'm just scared that I get it wrong. So if I could please come back.

MR O'DONOVAN: Sure. All right. If I can just press you on that though. Are we talking a tiny percentage?

MR REITZER: I was going to say 20 per cent, but I'd really like to check it please.

MR O'DONOVAN: Right. But it's not, you know – it's not a tiny minority of stores that have?

MR REITZER: It would be 20, 25, as a very top of mind rough guess.

MR O'DONOVAN: Yes. No, that's fine. All right. Well, we might leave the remainder of that discussion for later on. Now, the – it's no secret that Metcash is currently expanding its operations from packaged groceries into fresh elements?

MR REITZER: Yes, that's correct.

MR O'DONOVAN: Okay. And this is effectively a new move for – and a relatively recent move for Metcash, is that true to say?

MR REITZER: That's true.

MR O'DONOVAN: Okay. Now, if the statements of Mr Cummings are true, and the other retailers, that you make very low margins, or no margin at all, on products supplied by Metcash, and you make your profit by getting good margins on all the other products, does this – this suggests that the IGA stores and the other independent stores that Metcash supplies would not voluntarily want to shift across to be sourcing their fresh produce from Metcash. Would you agree with that proposition?

MR REITZER: Not at all.

MR O'DONOVAN: So even if we accept that's in the fresh, in the deli, in the meat, and other areas that Metcash currently doesn't supply that these stores make their money, you don't think that they would be unwilling to switch across to give Metcash a further proportion of their business?

MR REITZER: Well, what's happening in the market is exactly the opposite to the picture that you paint, that where we have established the supply chain retailers are switching across at a significant rate.

MR O'DONOVAN: Okay.

MR REITZER: And unfortunately the whole basis for your question is incorrect, you know. The departments in a retail store that we supply makes certain margins that are very, very similar to what the chains make, and the fresh categories that traditionally Metcash haven't supplied, and are going to supply, are higher margin categories, but the retailers that do buy from us where we have established those fresh capabilities the margins sometimes are better than what they used to make when they were buying from the market or from other wholesalers. And the overall profitability of a retail store anyway comes back to high – allocates the cost – I don't know how they allocate their costs between grocery and fresh, but they are exactly the same as the chains.

If you run good fresh departments you'll make gross margins anywhere from 30 – maybe 32 to 40 per cent, but your shrinkage is high because your wastage is higher, and in dry grocery, where you have little – very little or no wastages, all you make anywhere from 18, 20 per cent GP. But then I don't know how they allocate the cost of doing of business to come up with that decision. But the retailers that have come across they wouldn't be coming across to our fresh supply chains, where we have them in droves, if they immediately then didn't make money on their fresh either. I mean, it's - - -

MR O'DONOVAN: Sure. So what – so since its introduction - - -

MR REITZER: Yes.

MR O'DONOVAN: - - - of the stores that you supply, firstly, what percentage of, say, Super IGAs have come across?

MR REITZER: We only have a fresh supply chain in – for fruits and vegetables in Western Australia and Queensland, and we have recently completed certain acquisitions which is – but it's like a week old, so I can't talk about that – in New South Wales, and we're busy in Victoria and South Australia. So if we just talk Queensland – I should remember the number – it's about 280 stores that buy their fruit and vegetables from us at the moment split – I can't remember the split – split between Western Australia and Queensland.

MR O'DONOVAN: Okay. And in terms of the potential market in those two States, how many stores would buy their packaged groceries from you?

MR REITZER: In Western Australia we have about 350 IGA stores, and in Queensland we have about 400.

MR O'DONOVAN: So it's about a bit more than a - - -

MR REITZER: It's out of about 700, yes.

MR O'DONOVAN: All right. Now, what incentives have you given to the stores to come over?

MR REITZER: There are trading terms that relate to fresh. So the way fresh works is totally different to dry groceries. So there are trading terms, rebates, pricing. And the other complication in fresh is that you have to tell us the quality that you want. So a fruit and veg, we would go and see a retailer about fruit and veg and he'll say, listen, I want A quality or AAA quality, or what I really want is price and I'm not worried about the size of the fruits and so on. So they choose the quality and then we give them a price format for that, and we ask them what sort of margins they want to operate on, and then the pricing and the structure gets done around that.

MR O'DONOVAN: All right. So there's no attempt to use your power in dry groceries to get people to convert to fresh supply?

MR REITZER: Okay. I think what you're referring to is what we call our team work rebate. So it hasn't been finalised yet. It's in design, and it's actually come out of the PWC study. So it's one of the things that have come out of the PWC study that I can take you through in the closed session. And obviously the more we supply of a retailers purchases the better our supply chain is. So if I send a truck and it's got four pallets on it, but if I send a truck and it's got eight pallets on it, two of which are fruit and veg, and one is meat, etcetera, they're savings for Metcash. So we're trying to design – it's not complete, it's nowhere near complete - what we would call a team work rebate.

So you get your – what we envisage happening is that you would get your trading terms on dry, frozen and chilled, you would get your trading terms on fresh, and then over on the top of that there would be an umbrella that says if you get your team work score. So your participation that you buy from us to 85 per cent there might be another X percentage over that which is sharing the benefits of the volume – more volume coming out of one distribution centre.

MR O'DONOVAN: All right. But it is true to say that that is, in part, leveraging your – the fact that you already supply - - -

MR REITZER: Yes.

MR O'DONOVAN: - - - already – they have no alternative other than to buy packaged groceries from you and say they will get a better price on those things – products – if they also buy fresh from you?

MR REITZER: No, they have alternatives to buy elsewhere. What it's saying is just exactly the same as our competitors, if you channel everything through fewer supply chains, fewer invoices, less drops, it's cheaper, and here is the share that benefit with you. So it's the way Metcash has operated from the last 10 years. The more you support us, the stronger we get, the stronger you get, the lower the cost to serve, the more that comes on the truck on one drop it's cheaper, and there's benefits. And there's – you can either do it through lower service fees, bigger rebates, extra rebates. So that's how we operate. There's no forcing.

So if a retailer says this is the deal I get on dry, I don't want – I employ a person that goes to the fruit and veg market at 3 o'clock every morning to buy the best fruit and veg you could possibly get and I don't want to use your supply chain, nothing changes.

MR O'DONOVAN: Okay. So – and is that true also for people who have signed up to the supply agreements? Do the fresh fruit and veg products become products listed.

MR REITZER: Does the fresh – I'd have to go check that. I don't – we don't – I don't think we have anyone with a supply agreement for fresh.

MR WATSON: No, the fresh business is a fledgling business.

MR REITZER: It's brand new, yes.

MR O'DONOVAN: All right. So the customers – people who have signed supply agreements won't be forced into buying their fruit and veg from Metcash by it becoming a listed product?

MR REITZER: I would like to go and check before I answer that, because I have just thought of one retailer that we do – we don't have a supply contract with him, but we have a deal with him on fresh, but it doesn't force him to buy from us. And I know that he buys things on the market directly still.

MR O'DONOVAN: So the only incentive for them is this team score?

MR REITZER: Well, the incentive is they would only buy fresh from us if we earn the right to supply it. So price service and quality they're happy with us, and they can make the margins that they want to make at their retail store, and the quality and everything is okay, that's why they would switch their supply chain to us. And then, secondly, if they do that, and we have lower cost to service that retailer, we share it to them through a team – we propose to share it to them – share those benefits with them through a team work rebate.

MR O'DONOVAN: Okay.

THE CHAIRMAN: You might just want to have your legal counsel check the definition of products in that agreement, and then you might want to rectify the answer you gave before, because I think you'll find that products – and I have got to be cautious because these are confidential, but – so stop me if I'm going to far – but products means those goods supplied and referred to any list of products published by Metcash or any subsidiary from time to time.

MR WATSON: I think we might need to stop you.

THE CHAIRMAN: Yes, righto, okay.

MR WATSON: That's something we'd be only too happy to take the Commission through in greater detail in camera.

THE CHAIRMAN: Okay.

MR O'DONOVAN: Okay.

MR WATSON: Sorry, the other point that I'd really want to reinforce is that the fresh business – IGA Fresh – is literally only, you know, in it's infancy.

MR REITZER: Brand new.

MR WATSON: So we're just getting into the game, figuring out how to make it all work.

MR O'DONOVAN: All right. But you'd agree that there is that – fledgling though it is – that there are incentives to Metcash to use its power in the dry groceries sector to get customers on board in its – for its fruit and veg service?

MR WATSON: I don't think that that's quite - - -

MR REITZER: They're not incentives for Metcash, they're benefits to Metcash which then Metcash is willing to share with the independent retailer, yes.

MR O'DONOVAN: All right. Now, in terms of another alternative way of retailers getting sources of supply is to deal direct with manufacturers?

MR REITZER: Yes.

MR O'DONOVAN: Okay. Now, does Metcash do anything to prevent retailers from doing that?

MR REITZER: No.

MR O'DONOVAN: Okay. Does it have agreements with the manufacturers that effectively make it pointless for retailers to attempt to deal direct with a supplier when the product is available from Metcash?

MR REITZER: Not that I'm aware of, no. I mean, you might get a manufacturer that decides not to supply direct, but not that I'm aware of.

MR O'DONOVAN: Okay. So are you aware that Metcash does have exclusivity arrangements with particular manufacturers or suppliers?

MR REITZER: For certain products, I'm not across the detail. I'm not a buyer in the organisation, but maybe, yes, could be.

MR WATSON: Sorry, could I just clarify. Are you referring to fresh still or grocery?

MR O'DONOVAN: No, no, we'll shift now to - - -

MR WATSON: Back to grocery, okay.

MR O'DONOVAN: - - - back to groceries. So in dry groceries you can't think of any clause in your arrangements with a supplier that would have the effect of rendering it pointless for a retailer to attempt to do a deal direct with that retailer?

MR REITZER: I'm afraid I'm not across that, so I can't answer the question.

MR O'DONOVAN: All right. Now, I would take you to specific trading terms, but before I do I just want – would these be confidential as well?

MR WATSON: Absolutely.

MR REITZER: Extremely, yes please.

MR WATSON: There's confidentiality obligation splashed across the front page there.

MR O'DONOVAN: Sure. Okay. Well, look, we'll deal with that issue again in the confidential session. Okay. Now, for a competitor to emerge in the wholesaling area, you would agree with the proposition that you need a minimum volume of throughput through the warehouse to make it financially worthwhile to make them competitive in the market place?

MR REITZER: Yes.

MR O'DONOVAN: Okay. So it's in Metcash's interests to put in place arrangements that make it difficult for a person to accumulate the kinds of volumes that would be necessary to set up in competition, would you agree with that?

MR REITZER: Only from the point of view that it's in Metcash's interest to lock as much of their volume in as possible, yes.

MR O'DONOVAN: Yes, all right. And can you tell us about the specific strategies you have adopted to lock in those volumes?

MR REITZER: Yes, first strategy is to have the best price service and quality to independent retailers at the most competitive pricing. So we work 365 days a year to take the aggregated volume of all our retailers to negotiate as hard as we possibly can, and so that if a competitor came along he would have to beat our prices, and our service, and our quality. The second is to create branding and all the jobs that we do for independent retailers that adds so much value to the independent retailers and allow the independent retailers to compete and run promotional programs so that if someone came along they'd have to compete with all of that.

And that goes through to supporting eight different kinds of IT systems, monitoring the opposition, producing host prices of host ..... that they can sell at the correct selling prices, business managers that call on the stores to do store appraisals, having three to four to 5000 items on promotion, coming up with all sorts of innovative marketing programs like locked in low prices, local heroes, having people go out to the store to merchandise the shelves, and very, very strong house brand strategies. So within Black and Gold, and IGA, and then obviously FoodWorks have their best buy strategies.

So that if any retailer wanted to leave us and go to an opposition they would lose all of that. Those are all part of the competitive ....., one of the ways, I suppose, we keep competitors out. Then the last way is where we do have a financial exposure. Where we do face a particular risk is to try and negotiate the supply contract.

MR O'DONOVAN: Okay. And in terms of the – and so that supply contract has the effect of locking that person in and locking out alternative sources of supply?

MR REITZER: Well, it says unless they can get it cheaper or better elsewhere they must buy it from us if it's listed in the warehouse.

MR O'DONOVAN: Okay. So – now, you also take equity positions in retailers, but you never – but these are always minority equity positions?

MR REITZER: That's correct.

MR O'DONOVAN: Why is that?

MR REITZER: Despite what was said earlier, return on investment and profitability in the independent sector, to the best of our knowledge and according to our numbers, has never been better. And what happens, as a result of that, is there is significant growth opportunities in the sector. Each year we add somewhere between 35 and 50 new stores. We do approximately 95 major refurbishments through our store development department, and we have organisations such as the FoodWorks banner which have some, you know, three, 400 new stores on their radar. Unfortunately, one of the rules, or one of the phenomenons in our industry is that the most difficult thing for a single store IGA retailer, or a FoodWorks retailer, is to get the second store.

They don't – you know, it's – when you're running one store and it's your family business, and even if you're doing well, how do you manage a second store. So what happens is little chains start forming up where multi-store owners get five, 10, 15, up – I think our biggest retailer has 70 stores. Our second biggest retailer has about 55 stores. And to provide the funding for growth, and to support them, we take a 26 per cent share in their business. The reason it's 26 and not 25 is that it gives us certain minority shareholder rights in terms of the company law. But that money, up until now, has never been taken out of the business. It's introduced as fresh capital to fund the growth to take advantage of all the store development opportunities that are there.

MR O'DONOVAN: Okay. And is one of the consequences of taking that equity position that they're, effectively, locked into the – or, at least, Metcash is able to strongly influence them to retain acquiring their volumes from the Metcash group?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. So it's part of a lock in strategy?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. And it's primarily employed in those larger groups?

MR REITZER: It's only employed in the larger groups.

MR O'DONOVAN: Okay. So it's not really an investment – it's not really about investment for return, it's really about locking in Metcash's primary business, which is the wholesaling business?

MR REITZER: Yes, that's correct. Other than the one – if you look at it from a return and investment, they're all lousy because all the retail – the money has been used to build new stores and grow the business. And with any retail store, the first two or three years you lose money, and then the third, fourth year you break even. So if you look at it purely as a return on investment in the short term, the return is very poor, but then once they get up on their feet then it's the normal return.

MR O'DONOVAN: All right. So – now, in addition to that, because you have a place on the board, presumably you get information about the performance of the retailer?

MR REITZER: Yes.

MR O'DONOVAN: Okay. Now, you have said in your public submission to the Commission that Metcash, as a wholesaler, does not have extensive data on margins on retailers, and is not in a position to comment on the margins of retailers. Now, that's not true is it?

MR REITZER: I only have the permission – how many ..... do we have, about six? So I have the information for six.

MR O'DONOVAN: Sure. But you have also had the benefit of the Pricewaterhouse study?

MR REITZER: Which we – yes, which we included in our submission.

MR O'DONOVAN: No, I think you included it in material that was compulsorily required by the Commission.

MR WATSON: That’s correct, yes.

MR REITZER: I beg your pardon, you’re correct.

MR WATSON: You ..... on a confidential basis.

MR REITZER: Yes, I beg your pardon.

MR O'DONOVAN: Yes. So in terms of this public statement, Metcash, as a wholesaler, does not have extensive data on the margins of retailers and is not in a position to comment on the margins of retailers. That’s actually not true is it? You are in a position. You have just chosen – you just chose not to in your public submission.

MR REITZER: I mean, in terms – we have limited information, other than the PWC report which was an overall study, but that’s also at a very ..... level. For example, it doesn’t talk about gross margins, it just talks about EBIT.

MR WATSON: So the other point to make is that, in connection with the PWC study, is that there are strict confidentiality obligations on Metcash in connection with being provided that data by the retailers. So we simply could not put that in in any public submission.

MR O'DONOVAN: Sure. Which is quite a different statement to saying that you don’t have extensive data on margins, and are not in a position to comment.

MR WATSON: I accept it’s a different statement, but both of those statements are absolutely true.

MR O'DONOVAN: So are you saying that you’re not in a position to comment on the margins of retailers?

THE CHAIRMAN: Sorry, have you changed your question slightly?

MR O'DONOVAN: I’m just quoting - - -

MR WATSON: Before your question was, do we have sufficient data to comment on it, and now you’re saying are we in a position to comment.

MR O'DONOVAN: I’m just quoting to you, and asking you whether you stand by this statement as truthful that Metcash, as a wholesaler, does not have extensive data on the margins of retailers and is not in a position to comment on the margins of retailers?

MR REITZER: That’s correct.

MR O'DONOVAN: That’s correct?

MR REITZER: Yes.

MR O'DONOVAN: Notwithstanding that you sit on the board of the largest retailer of groups, that you have conducted the PWC study, that you have spoken knowledgeably about the margins this morning, you still stand by the submission, that you made for publication, that you're not in a position to comment?

MR REITZER: My understanding to be able to answer the question that as asked, and the answer there is that I'd have to have to knowledge over an extensive period. So if I had done the PWC study and I was allowed to submit it over five years so that I could say, look, what's happened to the margins exactly, I have got the exact data, I can show you the trending, I would have been in a position to answer the question under confidence, but to answer the question better. What I have is six half yearly board meetings, or five, I think, with a handful of our retailers, and I see there P and Ls, and they're not representative of the 1300 because they're all in extreme growth phase. So when you're in growth phase the margins aren't normal margins because you have so many new stores.

And the PWC is a snapshot in time. It's a snapshot in time. So what they were a year before, and if they have gone up or down from a year before, I can't say with any confidence. So that's we answered that question – or Ray answered that question like that.

MR WATSON: Sorry, could you refresh my memory. Was the question specifically limited to IGA retailers, or was it independent retailers, or was it retailers that were supplied by Metcash?

MR O'DONOVAN: It was just a general question about the factors in increasing food prices.

MR WATSON: Absolutely, we stand by that. We stand by the response, absolutely.

MR O'DONOVAN: All right.

THE CHAIRMAN: So what you're saying is that the PWC survey is not terribly helpful? I just want to know how much time we'll spend or waste on it this afternoon, that's all. If it's only a snapshot, and it's not that helpful, and it doesn't give you an opportunity to comment upon retail prices and retail margins, then is it that helpful?

MR REITZER: PWC, Commissioner - well, the PWC report was extremely helpful to us to get an understanding of the margins that are made at the retail level, and to be able to compare our cost of doing business as a sort of integrated wholesale retail chain to that of our competitors, and to understand the margin that was available and how it was being shared between us and our retailers. It also then focused on one of the threats to our industry and what are the five or six things we need to change going forward, which is why it's confidential. Back in - - -

THE CHAIRMAN: But it's a pretty flimsy basis because you have just said it was a snapshot, and you have said it affirms or confirms the statement that you made in your public submission which is, Mr O'Donovan?

MR O'DONOVAN: Metcash is a wholesaler. Does not have extensive data on margins of retailers and is not in a position to comment on the margins of retailers.

THE CHAIRMAN: Which is a direct contradiction of what you have just said barely 30 seconds ago about the PWC survey. So I'm just trying to understand. I mean, we were happy for you to keep the PWC consultant here, but if it's only a snapshot and it's not that helpful then I'm just wondering why we're wasting our time on it.

MR REITZER: Mr Commissioner, with respect, we're not wasting our time. It was an extremely useful study for us. It allowed us to understand where we were at this point in time. In terms of providing the information for us to be able to answer that question and say this is what's happened to retailers margins over the last three to five years, it does not provide that data, but it provides us with a very good snapshot of what the profitability is in the industry at this point in time and, therefore, allowed us to develop a strategic plan which is what it's all about.

THE CHAIRMAN: Which I think is the very question that we asked, and was the question that you answered but, in fact, you have answered in different terms to what you're now answering. So I'm just trying to reconcile the two, that's all.

MR REITZER: My understanding, when we answered the question, and we tried to put our submission in to the best of our ability, was - the question was, do you have extensive knowledge of retailer's margins, and what they are, and how they have been tracking, and what is the trends. And I assume behind that is trying to get to the bottom of answering the question is, are higher food prices at Australian supermarkets the result of retailer's increased margins? Has there been margin gouging, have retailers been taking more and more margin and that's why Australian consumers are paying more? I can't answer that question. I don't have in-depth knowledge.

What I have is a snapshot in time. So was that number half or double it two to three years ago? I'm terribly sorry, we don't have that information which is why I answered the question like that. But the PWC study is vital for Metcash and its retailers anyway.

THE CHAIRMAN: Right. And were you – on what information do you base your comment that you made before – and I think I can quote you in saying this.

That the return on investment and growth in the independent sector has never been better.

MR REITZER: Feedback from all my retailers, and the market growth and stats out of Nielsen, and the six boards that I sit on, and the numerous requests that we get for financial assistance which we then give, and then monitoring those accounts until they get paid. They wouldn't be able to pay off their loans if the business investments that they made weren't good.

THE CHAIRMAN: So:

Return on investment and growth in the independent sector has never been better, and we're providing a competitive tension.

And what flows from all that?

MR REITZER: That the Australian retail market place is a competitive market, and that independents play a vital role in those places that they have stores greater than 1000 square metres and creating that competitive tension.

THE CHAIRMAN:

Resulting in a return on investment and growth being – never been better.

MR REITZER: Yes.

MR O'DONOVAN: All right. Now, then looking at whether there are other ways in which you lock in retailers so that it is more difficult for them to exit and take up an alternative warehousing operation. You have IGA alliance agreements?

MR REITZER: Yes.

MR O'DONOVAN: Okay. What's the usual period for those agreements?

MR WATSON: The alliance agreement is simply the trademark license, and the usual period – can I just take a moment to review or we can – off the top of my head I believe they have a rolling term.

MR REITZER: The initial term is five years and then it rolls over for a further five years.

MR O'DONOVAN: Okay. Now, are there any features of the IGA alliance agreement that assists your lock in strategy, locking in retailers to Metcash supplies?

MR REITZER: The notice period that a retailer has to give us to leave is three to six months.

MR O'DONOVAN: All right. And that's the only way in which it locks in Metcash as a supplier?

MR REITZER: That's the way they would – unless there's another supply agreement, they would just give us notice of three to six months.

MR O'DONOVAN: Okay.

MR WATSON: Sorry, it should be clear that the – when you say the alliance agreement locks into the supplier, that's not correct.

MR O'DONOVAN: Well, it was a question. Well, are there features of the alliance agreement that assist in locking in Metcash as the wholesale supplier that make it difficult for a retailer to engage in alternative wholesaling arrangements?

MR REITZER: The alliance agreement is primarily around the branding, and following the marketing strategies, and executing all the IGA branding strategies. So that's – if you leave then you lose all of those, and you give three months notice to leave.

MR O'DONOVAN: All right.

MR REITZER: So the real lock in is if those – if that branding, and the promotions, and the marketing all around IGA is very good, and your turnover is higher as a result, and your store is worth more as a result, that's good. That's – those are the hooks.

MR O'DONOVAN: All right. But if you stop buying from Metcash you couldn't keep your store branded as an IGA store?

MR REITZER: No.

MR O'DONOVAN: So all of that investment in signage and store fit-out and all of that would all be lost?

MR REITZER: In the signage, yes. The fit-out is the same.

MR O'DONOVAN: Yes.

MR REITZER: But the signage.

MR O'DONOVAN: So that there would be capital costs incurred as a consequence of the decision to leave the IGA group?

MR REITZER: Yes, you would have to re-sign write your store into whatever other banner you have joined or just another name, and you couldn't use the staff uniforms. That would be it.

MR O'DONOVAN: Okay. So essentially the franchise element of the IGA business reinforces the wholesale supply element that Metcash provides?

MR REITZER: Yes, although it's not a franchise like a McDonald's, it's more of a licensing system because we're just licensing the retailer to use the brand, and they are agreeing to follow all the rules around the use of the brand.

MR O'DONOVAN: Okay. But, again, that makes it more difficult for the retailer to leave and find an alternative wholesaling arrangement?

MR REITZER: Yes.

MR O'DONOVAN: Yes, okay. All right. Now, there's one other – at least one other major wholesaler operating in Australia, and that's in Tasmania. Are you aware of that?

MR REITZER: Yes.

MR O'DONOVAN: And what's the name of that wholesaler?

MR REITZER: TIW or TIR.

MR O'DONOVAN: Yes, Tasmanian Independent Wholesalers.

MR REITZER: I think that one is the wholesaler and that one is the retailer – the banner organisation.

MR O'DONOVAN: Sure. And do you – are you aware of what margins they operate on in their warehouse?

MR REITZER: No.

MR O'DONOVAN: No, okay.

MR REITZER: I think if I recall correctly they are a co-operative structure. So all the retailers own the wholesaler. And in the case of Metcash, Metcash is a publicly listed company, so the shareholders own us. I think they are a co-operative wholesaler, and their wholesale business share the warehouse, share the state-wide warehouse with Woolworths. So there isn't enough volume in Tassie for just one. So they share the warehouse.

MR O'DONOVAN: Yes, but in terms of the margins that they make?

MR REITZER: I have no idea.

MR O'DONOVAN: You have no information about that?

MR REITZER: I would imagine that being a co-operative they are on a break even. So that if they do make money at the wholesale level it goes back to their retailers in the form of a dividend or something like that.

MR O'DONOVAN: And do you know whether that's had the effect of reducing retail prices for consumers?

MR REITZER: I have no idea.

MR O'DONOVAN: Okay. And have you looked at the warehousing structure in New Zealand?

MR REITZER: I know the Foodstuffs organisation in New Zealand quite well. We have a – we recently created a buying organisation with Foodstuffs called Metfoods, and we currently buy house brands and, what we would call, non-trade items. So computers, and plastic bags, and eftpos, and stuff like that with the Foodstuffs organisation through a company called Metfoods and we try and take our Trans-Tasman buying muscle to do a better job for both sets of independents.

MR O'DONOVAN: All right. And do you know what sort of margin it extracts?

MR REITZER: The only thing that I can recall would be about four years old that their dividend to their retailers – because they were also a co-operative. So any profit left at the end of the year they pushed down to the retailers was 4 per cent. But that's - - -

MR O'DONOVAN: 4 per cent of?

MR REITZER: Of the retailer's purchases from Foodstuffs. From the Foodstuffs Co-op. There are three co-ops. But, please, that's three to four years old. I haven't seen a report since then.

MR O'DONOVAN: All right. Okay. Now, then in terms of Metcash's efficiency and performance, does it keep statistics in relation to those things?

MR REITZER: Yes.

MR O'DONOVAN: Okay. And what does it benchmark itself against?

MR REITZER: We benchmark ourselves in a number of areas. The prime area in terms of IGA distribution is the efficiency of the warehouse. With a warehouse operation the mix of your orders that you get determines how efficient you can be. So, for example, a warehouse that only supplies big supermarkets can be much more efficient than a warehouse that doesn't. We, therefore, employ a system which has engineered standards. So what the system does is - because every day we have a different mix of orders. You know, we could have a lot of small orders, and only a few big orders, or lots of big orders, like, you know, it's different every day. So what our system, that we employ called ....., it used to be called Dallas, does, it calculates the engineered standard.

So it says, for this pile of work - because I know how the warehouse is laid out, or what the travel time is, what the pick path is - you should use, let's say, 100 man hours to pick this batch of work. And that's what we benchmark ourselves to every single day. And if you're at the engineered standard you operate it's called – it's a percentage. So you're 100 per cent of the engineered standard. If you're more productive you go to 103 or 105 per cent. If you're less you're under the 100 per cent. So every day we get that percentage.

MR O'DONOVAN: Okay. Now, the Commission has asked for that efficiency documentation, has it not?

MR REITZER: No. Engineered standards, no. No, but we can provide it.

MR O'DONOVAN: Well, we asked for documents in relation to the efficiency and performance, and we were provided with one page – a one page graph.

MR WATSON: Yes, we did receive an informal request on Friday evening, which we're in the process of - - -

MR REITZER: That's the second thing I was going to talk about.

MR O'DONOVAN: Sure. But just to stop you there. So you have not yet provided to the Commission any information about the engineering standards and your performance relative to it?

MR WATSON: No, I don't think we were asked about that.

MR REITZER: No, we weren't asked. To the best of my knowledge we weren't asked, but we can produce it quite easily.

MR O'DONOVAN: Sure. Okay. And in terms of how you are benchmarked on that engineering standard, what's the general performance?

MR REITZER: Okay. If you were to look at our engineered standards for the last four months, they haven't been great because we lost the warehouse in New South Wales because of a hail storm. And we had to do all the work for our New South Wales retailers here and in Melbourne and in Queensland and we just pushed through too much volume. So you get a deterioration. But if you leave those four months out, for all the picking it's very, very close to 100 per cent and the forklifts are usually about 105 or 108 per cent.

MR O'DONOVAN: All right. And just looking at that issue of the destruction of the warehouse, as I understand it that's because it had an asbestos roof which was smashed during a hail storm, is that right?

MR REITZER: Yes.

MR O'DONOVAN: Okay. Which is a pretty major mistake in terms of not having invested properly in your facilities, to ensure that they're hail proof. Would you agree with that?

MR REITZER: No, I disagree.

MR O'DONOVAN: You don't think it was a major mistake not to have the roof replaced or have an improved warehouse?

MR REITZER: No. The warehouse doesn't belong to us, it belongs to ING and we have four years left on the lease. I don't think there's any roof that would have withstood what happened there. And you have to understand, the hail came through the asbestos sheeting, through the insulation, through chicken wire underneath the insulation and through an internal office with a ceiling like this and broke the manager's desk. I don't know what we could have done to avoid that.

MR O'DONOVAN: All right. Well, putting that aside, the net effect was destruction of the warehouse?

MR REITZER: Yes.

MR O'DONOVAN: It made it inoperable?

MR REITZER: Yes.

MR O'DONOVAN: Can you tell us how many customers you have lost as a consequence?

MR REITZER: None.

MR O'DONOVAN: None. But it's true to say that your efficiency and performance has declined as a consequence of the loss of the warehouse?

MR REITZER: Yes.

MR O'DONOVAN: Yes. Which suggests really that it's the kind of mistake that only someone in a monopoly position could make? If you were in a competitive market - - -

MR REITZER: We didn't make - - -

MR O'DONOVAN: - - - you would have lost customers?

MR REITZER: I doubt it. But, no, we didn't.

MR O'DONOVAN: Not – even though you accept that your efficiency declined as a result of the loss of the warehouse and you lost exactly zero customers. You're saying that in a competitive market at the wholesale level, the result would have been the same?

MR REITZER: That's correct.

MR O'DONOVAN: So that people would not have switched?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. And why would they not have switched to a competitor that could achieve proper efficiency levels?

MR REITZER: Because we serviced our customers and because, as a wholesale distributor and as an champion independent retailer, we were able to switch on our disaster-recovery plan and yes, the first one or two days until we could get the trucks, because it happened on 9 December, and since then we have been servicing our customers - not always on time, but very, very close to - in full. Our service levels, in other words the percentage of the order that we supplied, did deteriorate a bit, but the majority of our customers, and they have all complemented us on the job we have done, and because there are so many things that was as Metcash and IGA did do for our retailers all around, other than just the supply of the goods, that they would lose all those things.

So they would lose the branding, they would lose the promotions, they would lose the store development, they would lose the business manager coming around to them, they would lose the great promotions we ran. It's not just the supply of goods. We do for our retailers exactly what a Woolworths or a Coles head office do. So, yes, if we had only serviced a third of their orders and the trucks just never came and no one ever phoned the retailer to tell them when their trucks were coming, in that case we would have lost. But we didn't.

MR O'DONOVAN: Well, sorry, who would you have lost to?

MR REITZER: The customers in far north – or all the New South Wales customers could have gone to ARLL, they deliver into the whole of New South Wales.

MR O'DONOVAN: The full range of SKUs that you provide?

MR REITZER: I don't know what ARLLs range is.

MR O'DONOVAN: All right. But they couldn't have done that without losing banner – if they had done that, they would have had banner consequences?

MR REITZER: They would have lost everything else, yes. They could have all joined Franklins the next day. Franklins have a warehouse right, smack bang in the middle of Sydney.

MR O'DONOVAN: Sure. But they would have incurred capital costs in switching?

MR REITZER: And they would have lost every single thing that we have built up and that we stand for, over the last ten years. That’s why they decided not to.

MR O'DONOVAN: All right. But some of which are contractual and only some of which are benefits in terms of service. You would agree with that?

MR REITZER: There would be some retailers in New South Wales that would have signed supply agreements but - it would be a small amount and if we weren’t supplying them according to that qualifier, they would leave.

MR O'DONOVAN: Right.

MR REITZER: They would be fully justified in going somewhere else.

MR O'DONOVAN: So you wouldn’t accept the proposition that Metcash has put in place high barriers to exit that make it difficult or impossible for someone else to provide wholesaling services to its client base?

MR REITZER: I wouldn’t put it from that tone of voice – or from the tone of the question, I beg your pardon. I wouldn’t put it from that tone of the question. But, yes, we do things to build retailers, we do things to build brands, have great promotions, have the most aggressive pricing, try to be innovative, come up with good marketing programs and we know that’s good the retailer which will be good for us. But, hey, it also hooks into the retailer which makes them dependent on us. And if someone were to come along and wanted to compete with us, they wouldn’t only have to beat us on the pure service, they would have to beat our pricing, our service fees and everything else that we do. And then they could leave us.

MR O'DONOVAN: Now most of those services that you talk about, additional to supplying wholesale groceries, are provided by FoodWorks. Is that right?

MR REITZER: I’m sorry, I was distracted, could you - - -

MR O'DONOVAN: Those additional services that you provide - - -

MR REITZER: Yes.

MR O'DONOVAN: - - - that you referred to as the reasons why people stay, are also provided by FoodWorks?

MR REITZER: Yes. Some of them are, yes.

MR O'DONOVAN: So there is a competitor in relation to those?

MR REITZER: Very much so, yes.

MR O'DONOVAN: Yes. But there is no competitor who could offer the supply of groceries and the services that FoodWorks offers, is there?

MR REITZER: Franklins and ARRL, are two - - -

MR O'DONOVAN: All right. But Franklins has told us that they're only interested in a, I suppose, a franchise model where everyone takes on the whole of the Franklins approach, not just supplying of warehouse goods?

MR REITZER: I see. I don't think - - -

MR WATSON: Don't speak for them. That's a matter for Franklins.

MR REITZER: I can't speak for Franklins, but if I have put together what you're saying. I don't think you can go and buy another Franklins warehouse and just, you know, call yourself ABC Supermarket, so you have to become Franklins. But they are a competitor, they're knocking on IGA stores every day of the week, saying "We're much better than Metcash. Join us."

MR O'DONOVAN: All right. Now in the last five years, you have, according to your accounts, had costs of doing business improvements?

MR REITZER: Yes.

MR O'DONOVAN: Now have all of those been retained by the shareholders in Metcash or has there been some passed through in the form of better pricing?

MR REITZER: I don't know how to answer that question, because, I mean, we have never done that study. So, I mean, we have gone for several years without increasing our service fees and then we had one increase in our service fees. So I suppose one way of looking at it is that the only reason we didn't have to increase our service fees was because we improved our productivity. And that would be a way of sharing. But I wouldn't be able to, I mean, maybe we can get someone to do the study but I wouldn't be able to say X per cent of it has gone to the retailer and Y per cent has gone to the shareholder.

I'm afraid I'm not in that position. But it's only natural to assume that the technological improvements we have made have been passed on to the retailers, either through the service fee that is paid or no higher service fee.

MR O'DONOVAN: Right. So there has certainly been no conscious decision on the part of Metcash to lower its fees, service fees, or specifically pass through lower prices generated by the decreased cost of doing business?

MR REITZER: Yes, there has been a conscious decision so every year when we do our budgeting we say that we forecast our customers' sales and then we work out what our service fee income will be and then we look to cover a proportion of our costs from that service fee and if it's not good enough we would have to go back to our customers and say: sorry, I need to charge you a high service fee. The majority of years we haven't had to do that because our costs have come down so we've made a conscious decision, as you say, not to pass it on or not to have to raise the service fees. In terms of competitive prices for our retailers that's what my organisation does during the 365 days of the year. We monitor that through a number of means to make sure that they can compete.

MR O'DONOVAN: But your profit expectations have gone up in terms of – and dividends to shareholders have gone up?

MR REITZER: Yes.

MR O'DONOVAN: And so would it be fair to say that the primary beneficiaries of the improved costs of doing business have been the shareholders?

MR REITZER: The primary beneficiary of what Metcash has done in the last 10 years has been the Australian consumer in that we worked very, very hard to build an effective third force in the Australian grocer and retail industry and taken their market share from 11 to 18, to 19 per cent and even in the words of my competitor, we are a formidable competitor where we have stores greater than 1000 square metres and the only way that I have returned greater share in returns to Metcash's shareholders is by doing an outstanding job for independent retailers so by servicing independent retailers better, by getting our costs down, by making sure they are competitive, by building fantastic brands my independent retailers have got a much better business now than they had 10 years ago and guess what, Metcash's business is also stronger and we have been able to return higher dividends to our shareholders every year. That's the way the cycle works.

MR O'DONOVAN: Now, you say that the primary beneficiary has been the customer?

MR REITZER: Consumer.

MR O'DONOVAN: Consumer. Now, the BITRE study suggested that in areas where there was only an independent that the prices were significantly higher than where there was a presence of a major change which suggests there is no voluntary pass through of these benefits to the consumer by an independent sector, is there?

MR REITZER: I haven't viewed that study so I'm afraid I can't comment on it.

MR O'DONOVAN: Well, it is quoted in your public submission.

MR REITZER: If I could make the point if there's only one competitor in an area, yes, prices would be higher than if there are two or three or five or ten. That's absolutely logical.

MR O'DONOVAN: And the basic proposition is that Metcash will not, and independent retailers, will not pass through a benefit to the consumer unless there is the presence of the major chains to compel them to do so.

MR REITZER: If there is an IGA store that has no competition and there's an IGA store that has 10 competitors which was in the same - as Metcash we don't say: oh, there's no competition in your area so let's take a – but which was in the same area. It's impossible for us to do any different. How that retailer then prices in his market. I mean, if the organisation that you quoted, if that's what they found then it must be true. I can't comment on that.

MR O'DONOVAN: But certainly - - -

MR REITZER: We don't benefit because our volume to that store that has no competition and he makes higher margins, our profits don't go up. It's the same.

MR LENNON: Probably sell less.

MR REITZER: Chances are, if you were silly enough to raise prices that much his turnover will be low and you'll make less.

MR O'DONOVAN: But certainly you don't make any contribution to the competitive pricing at the retail level?

MR REITZER: No. We make a significant contribution to the competitive pricing at retail level. In fact, if there wasn't a Metcash this inquiry would be about two players in the market full stop.

MR O'DONOVAN: All right. Well, then, if I understood your earlier answer, it was saying that you're not responsible for the pricing of the retailers, you price everything the same. Now, you are saying that you make a significant contribution at the retail level. Okay?

MR REITZER: Yes.

MR O'DONOVAN: How can you reconcile those two answers?

MR REITZER: Because what we've done is taken the combined volume of all the independent retailers in Australia, negotiated as hard as possible and on a number of other things other than just a trade, passed it on to all the retailers. We've put brands, marketing and put promotional programs, just like the chains have, into the market that have benefited all independent – all consumers. So that IGA store that they quoted would be running the exact same promotion as all the other IGA stores in the

State, whether it was a FoodWorks store, exactly the same. However, what they are saying is that the shelf prices in that IGA store because there is no competition in the area, are a little bit higher.

We can't be responsible for that and we have absolutely no power to do that but the promotions, the 30 to 40 per cent of your sales would be at the same specials and buy two, get one free, all the marketing gimmicks that we employ would be exactly the same in that store as the rest of the State and that's the contribution that I have made which, you know, I would be surprised if anyone said that was insignificant.

THE CHAIRMAN: Well, Mr Cummings does. But he said it's so insignificant that it's a loss and Mr Zelinski says that he can do better elsewhere. So that is the difficulty I'm having trying to reconcile those propositions you are putting with the advice of Mr Cummings who represents seven and a half thousand of your customers and Mr Zelinski who was a former customer but has exited because he says that he couldn't compete, couldn't provide, to use your words, that competitive tension and that he can do a better vertically integrated wholesale and distribution, that is retail arrangement, without having Metcash there as the wholesaler.

So how do we reconcile those views? Let's put Mr Zelinski aside and reconcile Mr Cummings' view which is fascinating coming from the president or the chairman of NARGA which is funded by Metcash and represents the seven and a half thousand customers of Metcash.

MR REITZER: I mean, in the final analysis, Commissioner, consumers vote with their feet and if the things that you are alluding to are true our market share would not have gone from 11 to 19 and our ..... sales would not have been higher than our competitors for the last five or six years and customers like FoodWorks who also produce statistics that show increased basket size and higher ..... sales would not exist if what Mr Cummings and Mr Zelinski said are true and the opposite would be in the case of Franklins, their market share would be going in the opposite direction to what it is if what they said it was – if what was said was true because in this market we get measured every single day by the consumer who has the luxury of choice of where to go.

THE CHAIRMAN: Well, all that would be the case except if you had a highly concentrated wholesale market for the supply of dry goods groceries like a monopoly in which case you could expect the market share would grow, margins would grow, profits would grow but that is the nature of what monopolies do.

MR REITZER: By saying that Metcash is a monopoly assumes that we can put up our prices to our independent retailers. If we did that they wouldn't be able to compete with Woolworths and Coles and the boss of Coles wouldn't sit in the seat and say that we are a formidable competitor and, yes, there is only 20 per cent of the volume in Australia left for independent retailers – for wholesalers to supply. If it was 40 there would be two Metcashes, if you had 60 there would be three Metcashes. There isn't but we have natural competitive tensions put on us at retail and at wholesale level by our two major competitors and I don't think that the profits that Metcash or its independent retailers are making have led to such higher consumer prices that have resulted in price ..... which obviously when Franklins left us they claim that that stopped because in - I mean, this market very, very quickly in a very short time and space and we have seen that happen with a number of our competitors, we would be out of business.

THE CHAIRMAN: I am not querying whether it has led to higher prices but I guess one of the big questions that we have to ask is whether the much flaunted champion of the independents has actually led to lower prices, to that competitive tension that you talk about and we are faced with some conflicting evidence. We are faced with your evidence which suggests that you are the champion of the independent sector and then we have the representative of the independent sector, Mr John Cummings, who says: well, yeah, look, Metcash is someone who funds NARGA but I have to say to you, he says on the record, that we make no profit at whatever Metcash supplies us and Mr Zelinski says, we make so little profit we have actually gone elsewhere. That’s what I am trying to reconcile.

MR REITZER: I have a whole different set of numbers and facts and market stats that, with respect, show exactly the opposite so I am struggling to answer your question.

HIS HONOUR: Yes, I am struggling as well but anyway. Sorry, Mr O’Donovan. Do you want to take a break at a point of time?

MR O'DONOVAN: Look, I will just ask one quick set of questions.

HIS HONOUR: Yes, sure.

MR O'DONOVAN: And then take a break. Just in relation to NARGA, firstly, what is the relationship? Is it funded directly - - -

THE CHAIRMAN: Well, before we get into that because I have got a whole of questions to ask about NARGA so I think it might take us a bit longer than perhaps the couple of minutes that might be necessary. So can we leave that?

MR O'DONOVAN: Yes, we can.

HIS HONOUR: All right. Okay. Let us take a break for lunch and what time do you want to resume? Sorry, did you want to ask more - - -

COMMISSIONER KING: No, no. I was just seeing, Mr O’Donovan - it might be helpful for the members of the press also if we get a feel for confidential versus non confidential questioning this afternoon.

MR O'DONOVAN: I think it’s probably another hour of public.

THE CHAIRMAN: Public? Yes, I would think so.

COMMISSIONER KING: So a half an hour break then?

THE CHAIRMAN: Are you happy with half an hour or you would like longer? No? Half an hour. We will have half an hour break and be back here at 1.30.

ADJOURNED **[1.04 pm]**

RESUMED **[1.44 pm]**

MR O'DONOVAN: All right. Now, I wanted to ask you about your relationship with the National Association of Retail Grocers of Australia, NARGA. Okay. Firstly, formally what is the relationship between Metcash and NARGA?

MR REITZER: One needs to take just one step backwards in that to understand that in each state of Australia independent retailers have an association, so there's like a Western Australian association, Queensland, New South Wales, etcetera. And they all belong to a national association called NARGA which used to be presented on a body called the Australian Supermarket Industries. So there was an overall Australian Retailers Association and then the supermarkets had their special division, and NARGA used to sit in with all the chains and I used to be party to that. And the Australian Supermarket Institute used to lobby state and federal governments on issues that affected supermarkets that were non-competitive. So we never had any competitive issues there but, like the packaging covenant, plastic bags, issues like that.

After serving within the Australian Supermarket Industry for two to three years we – or our retailers and us decided that things seemed to be always going the way of the chains so we decided to leave the Australian Supermarket Industry and push our own barrow. And, therefore, NARGA pulled out of the Australian Supermarket Industry and it then subsequently collapsed. And NARGA is an association that lobbies the interests of their members which is the state bodies across Australia. They do surveys of their members and then go and lobby state or federal governments on issues that would affect their retailers. They do approach us for help, both financially and other, and we give it very very willingly.

We think it's very very important that most independent retailers are in an intensely competitive situation and don't have the time, the money or the resources to get their voices heard. Some of them are – and I would say the majority of issues that NARGA lobby for are good for the – I mean, they are all good for independent retailer if they were to get their voice heard. And then anything that is good for the independent retailer obviously is good for Metcash. We're sort of an integrated chain and we help and support them, as I mentioned, financially and in other ways to make them big and strong. We don't have any issues with that. We're the champion of the independent retailer, and they need to get their voice heard because the voice of the opposition – I mean, the chains do exactly the same.

The chains since the supermarket institute failed have formed another body called the Australian National Retailers Association. Margy Osmond is their boss, and they get their voice heard in terms of all the issues with state and federal politicians.

MR O'DONOVAN: Okay. So in terms of this financial help that you give them, is it just a cash donation that you give them?

MR REITZER: Yes.

MR O'DONOVAN: Okay, and how big a cash donation?

MR REITZER: It's a few hundred thousand dollars each year.

MR O'DONOVAN: Okay, and is that their only source of funding?

MR REITZER: No, that's to top up the difference between their expenses and what they get from their members.

MR O'DONOVAN: Okay, and in terms of their members, is there some kind of compulsory levy on - - -

MR REITZER: I don't know.

MR O'DONOVAN: - - - on independent supermarkets?

MR REITZER: I don't know.

MR O'DONOVAN: You don't know. So Metcash doesn't have any role in levying membership fees?

MR REITZER: There's – I'm not sure of my facts but I could check. I think there's one state which would be Queensland where the Queensland Retailers Association asked us to collect the money for them, from all their members. They gave us a list of who their members are and we collect it and give it to them. I think there's only one state that we do that.

MR O'DONOVAN: All right. So it's effectively a charge through - - -

MR REITZER: They give us a list of their members, and then if comes – every retailer – it's like a sundry invoice where we invoice you for plastic bags and other stuff that's non-trade, and it would be on that invoice.

MR O'DONOVAN: Okay. So in Queensland Metcash actually charges the levy on a Metcash invoice for funds that ultimately go - - -

MR REITZER: For the Queensland Retailers Association, yes.

MR O'DONOVAN: All right. And then other than that, Metcash's only financial contribution to NARGA is to then make a several hundred thousand dollar cheque once a year?

MR REITZER: I think it's four times a year.

MR O'DONOVAN: Four times a year.

MR REITZER: Yes.

MR O'DONOVAN: All right. And are you invoiced for it by NARGA?

MR REITZER: Yes, yes.

MR O'DONOVAN: And how is that amount set?

MR REITZER: I think at the beginning of the year they give us an estimation of what they think the shortfall is going to be, and then each quarter they tell us how much it was for that quarter or for the next quarter. I'm not too sure if it's in arrears or in advance.

MR O'DONOVAN: All right. And how often do you meet with John Cummings and the chairman.

MR REITZER: John Cummings is the chairman.

MR O'DONOVAN: Sorry, John – Mr Ken Hendricks - - -

MR REITZER: Ken Hendricks.

MR O'DONOVAN: Is the – what's his position?

THE CHAIRMAN: CEO.

MR O'DONOVAN: CEO. How often would you meet with Mr Hendricks or with Mr Cummings?

MR REITZER: Maybe three times, four times.

MR O'DONOVAN: A year?

MR REITZER: A year, yes, sorry.

MR O'DONOVAN: And when, for example, they make a submission to this inquiry did they discuss that submission with you.

MR REITZER: No.

MR O'DONOVAN: No.

MR REITZER: But they did send me a copy of it.

MR O'DONOVAN: All right. And did you pass on your views orally to them about it?

MR REITZER: No. I got a copy when it was in already.

MR O'DONOVAN: In already.

MR REITZER: When it was submitted already.

MR O'DONOVAN: So it is fair to say that they're very dependent on Metcash for their survival?

MR REITZER: Yes, if they didn't get the top up money from us their members would have to pay more.

MR O'DONOVAN: All right. Or the organisation would fold?

MR REITZER: Yes.

MR O'DONOVAN: Okay. Now, when you say that you take surveys of members, have you actually seen the survey distributed to members and the responses that have come in?

MR REITZER: No, I didn't – I saw the sort of summation feedback. I recall a meeting about two years ago where he said to me these are the issues that their members want them to address.

MR O'DONOVAN: And there were no issues in relation to Metcash arising from the members?

MR REITZER: When you say there were no issues, I mean if there's issues that affects the retailer they affect us.

MR O'DONOVAN: Issues where effectively there is a dispute between or a disagreement or disappointment at the way in which Metcash is performing on the part of retailers?

MR REITZER: No, that wasn't on the list.

MR O'DONOVAN: Okay. And is that because they were not asked about that issue?

MR REITZER: I don’t know, I didn’t see the survey.

MR O'DONOVAN: So when you say that they are a representative group, surely one of their functions should be to represent the interests of independent retailers if they depart from the interests of Metcash. Would you agree with that?

MR REITZER: Yes.

MR O'DONOVAN: Okay. But because they receive funding from Metcash NARGA isn’t free to do that, is it?

MR REITZER: That situation has never arisen, so I’m trying to think through it. So what you are saying is that if they wanted to lobby or drive a cause or whatever it is that would hurt Metcash, we would withhold the money?

MR O'DONOVAN: Yes.

MR REITZER: It’s never arisen.

MR O'DONOVAN: It’s never arisen. And do you think the reason it has never arisen is because the members know that there is no point in going to NARGA if they have a complaint about Metcash?

MR REITZER: I can’t answer that, I mean I wouldn’t know.

MR O'DONOVAN: All right. But you agree that the structure is if NARGA is purporting to attempt to represent the interests of independent retailers, then the funding of Metcash heavily undermines its credibility and ability to represent members in relation to Metcash issues?

MR REITZER: I’ve never thought of it that way but I suppose you are correct. I would, however, like to point out that there are several other touch points that retailers come and negotiate with us. So they don’t necessarily go through NARGA, they go through their brand and their trading – or their banner like FoodWorks. So those are the points where they come and fight about service fees and promotions and your truck was late and all the things that are normal daily business. I mean they are done at state and national level, so there’s lots of forums for that to happen with – I can’t really understand why they would use NARGA to do that for them.

MR O'DONOVAN: All right. And in relation to the NARGA submission are you aware of what FoodWorks’ position on NARGAs submission to this inquiry was?

MR REITZER: No.

MR O'DONOVAN: Do you know if they were supportive of it?

MR REITZER: I can't recall.

MR O'DONOVAN: Now, there was a Metcash representative present during FoodWorks' evidence to this inquiry.

MR REITZER: Yes.

MR O'DONOVAN: And they reported to you presumably in relation to what was said?

MR REITZER: The only thing I can recall is apparently Peter Noble, CEO of FoodWorks said that NARGA were unprofessional. I think that's the only comment that I can remember about another member and that they weren't a member, you know, that they didn't want to use NARGA, they did their own thing. That's all I can recall.

MR O'DONOVAN: Sure. But you can recall enough to know that?

MR REITZER: They said that they were unprofessional and that they weren't part of it, yes.

MR O'DONOVAN: Yes. Which suggests that in terms of representing independent retailers NARGA is not doing a very good job?

MR REITZER: No, that doesn't suggest that.

MR O'DONOVAN: It doesn't suggest that?

MR REITZER: No.

MR O'DONOVAN: What does it suggest?

MR REITZER: It suggests that's Mr Noble's opinion. You could be right, you could be wrong; it doesn't suggest that. I mean I think if - - -

MR O'DONOVAN: Let me put it this way. Given that NARGA is there to represent the interests of independent retailers and FoodWorks represents - - -

MR REITZER: 700.

MR O'DONOVAN: - - - on one count at least 10 per cent, but a very substantial number of members, if they are unhappy with what NARGA is saying that suggests that NARGA is not doing a very good job of representing the views of the independent sector; do you agree with that?

MR REITZER: It doesn't. They are not representing what Peter Noble believes should be the views of the independent retailers. I would guess that the majority of FoodWorks' members in Victoria definitely are all members of the Master Grocers Association. It used to be called Master Grocers of Victoria. Now, it is just the Master Grocers Association, and MGA is a member of NARGA and the president of MGA, Rod – I've forgotten his surname – is a director of NARGA and the FoodWorks members are definitely very, very strong members of the Master Grocers Association, so there is some sort of conflict there, yes. And they are FoodWorks retailer – no, Rod isn't a FoodWorks retailer any more. There used to be FoodWorks retailers on the board of NARGA.

MR O'DONOVAN: But not any more.

MR REITZER: Because he joined IGA.

MR O'DONOVAN: Which again suggests – so you don't accept that FoodWorks' position in relation to NARGA undermines its credibility to claim that it represents the interests of independent retailers?

MR REITZER: Yes. I don't accept that proposition.

MR O'DONOVAN: You don't accept that proposition, all right. Do you accept the proposition that Metcash's funding arrangement undermines their ability to represent independently of Metcash the views of independent retailers?

MR REITZER: No, I don't accept that. They represent the interests of their members. The point that I haven't thought of is that if the members were unhappy with NARGA – were unhappy with Metcash, would they utilise NARGA to come in and fight with Metcash on their behalf. That is where the only time a conflict would come in, but the jobs that they do on plastic bags, packaging, covenant, trading hours, they represent the interests of their members.

MR O'DONOVAN: All right. And in terms of the submission that NARGA has put to this inquiry would you accept the criticism that they represent the interests of Metcash more strongly than they represent the interests of independent retailers?

MR REITZER: No, our interests and our members' interests are the same.

MR O'DONOVAN: Well, with respect, they are not always the same, are they?

MR REITZER: Yes, you are correct, it wouldn't be 100 per cent.

MR O'DONOVAN: Well, you have substantial disagreements with your retailers often.

MR REITZER: No, I don't.

MR O'DONOVAN: You say you don't think your disagreements with Franklins is an indication that your interests and the retailers' interests can depart?

MR REITZER: I mean Franklins weren't a member of NARGA and Franklins haven't been active in trying to get legislative changes and things in the industry done and their conflict with us had absolutely nothing to do with all the issues that NARGA address.

MR O'DONOVAN: All right.

MR REITZER: No, Franklins after getting four years of great service from us left and sued us in court over a matter which we'll discuss in a closed session. I don't understand - - -

MR O'DONOVAN: Well, let's leave Franklins to one side. Then FoodWorks - - -

MR REITZER: Yes.

MR O'DONOVAN: You have disputes with FoodWorks.

MR REITZER: I have had disputes with FoodWorks, yes – Metcash has, yes.

MR O'DONOVAN: Yes. So again would you accept the proposition that there are circumstances where Metcash's interests and the independent retailers' interests depart?

MR REITZER: That could be the case, yes.

MR O'DONOVAN: All right.

MR REITZER: And in the case of FoodWorks on one or two occasions it did.

MR O'DONOVAN: All right.

THE CHAIRMAN: Let's take a fairly obvious one. John Cummings says on the record that NARGA members make no profit out of purchases from Metcash and if John Cummings representing the NARGA members was to say to Metcash, we'd like you to transfer some of your EBIT margins to our members by charging lower prices, that would be a clear divergence of interests, would it not?

MR REITZER: Yes.

THE CHAIRMAN: Can we just get some clarification. You used the word "top up" in terms of the funding from Metcash to NARGA. The evidence provided by Mr Cummings and Mr Hendricks is that it is about 80 per cent of NARGAs funding, and then I think Mr Cummings went on in his public hearing to indicate that if that funding were withdrawn then NARGA would disappear, it had no more role, it couldn't survive. So is it not true then that NARGA is entirely dependent upon Metcash's funding to survive? It has to be from what Mr Cummings says.

MR REITZER: From what Mr Cummings said, yes, but I would disagree with it, but if he said it - - -

THE CHAIRMAN: Well, he's the chairman and Mr Hendricks is the CEO and both of them seem to indicate, not with any ambivalence or equivocation, they seem to indicate that if Metcash's funding was withdrawn from NARGA it would disappear, there would be no more – Mr Cummings said that he probably would have less time – less need to travel over to the east coast because he could spend more time in the west. So if that's the case is it not true then that Metcash and NARGA are inextricably woven together?

MR REITZER: Yes, they are.

THE CHAIRMAN: Yes. And NARGA is there, to use your words, lobby governments?

MR REITZER: That's correct.

THE CHAIRMAN: For a range of issues, but not the least of which is for reforms to competition law to enable the independent sector to more effectively compete with Coles and Woolworths?

MR REITZER: That's correct.

THE CHAIRMAN: Yes and the interests of Metcash and NARGA are inextricably woven together, we've just said that.

MR REITZER: Yes, yes.

THE CHAIRMAN: So, is it not true then that NARGAs role is to lobby governments to provide reforms to competition law so that Metcash can more effectively compete with Coles and Woolworths through the independent retail sector?

MR REITZER: Yes, Commissioner, we're in - - -

THE CHAIRMAN: We're in line?

MR REITZER: I mean, we don't own share in anything but we're like an integrated chain.

THE CHAIRMAN: Okay, yes.

MR REITZER: So, what benefit - - -

THE CHAIRMAN: Sorry, I beg your pardon.

MR REITZER: Sorry, I was just going to say what benefit one piece benefits the other.

THE CHAIRMAN: So, why use NARGA, why not just do the lobbying yourself?

MR REITZER: Mr Chairman, Metcash, on its own back vigorously lobbies State and Federal Governments. Some of the issues overlap with NARGA, some of them don't because some of the issues that we would like to see addressed are purely on the wholesale side or on the manufacturer's side or on the grower's side, so we push our own barrow and NARGA push theirs.

THE CHAIRMAN: Well, yes, but they push yours.

MR REITZER: Some of things that – I - - -

THE CHAIRMAN: I think you said inextricably woven and - - -

MR REITZER: I can't think of - - -

THE CHAIRMAN: I'm trying to understand. What role does NARGA perform – I'm going to put a proposition to you in a moment but I'm trying to – I just want to get an answer off you before I, sort of, put words in your mouth, that's all.

MR REITZER: I can't – Mr Chairman, I can't think of anything that NARGA would push for that indirectly wouldn't benefit Metcash.

THE CHAIRMAN: Yes. So, why use NARGA?

MR REITZER: Because it was a body that was in existence when I arrived in this job ten years ago and it was, as I explained, in the Supermarkets Institute and when things in the Institute looked like they were just favouring the big chains, we had a meeting with our retailers and we said, "Well, let's go out and have our own voice heard." So, that – we didn't create it. That's where it was. It was always in there and instead of paying membership fees to the Australian Supermarket Institute on behalf of my members, we paid the money to NARGA.

THE CHAIRMAN: So, is NARGA just a front for Metcash?

MR REITZER: Definitely not. No, there's many things that they drive, that if they happen or they don't happen to be good for independents but it's not necessarily for us.

THE CHAIRMAN: I thought you were saying before – sorry, just to wind back a bit – that they're inextricably woven, NARGA and Metcash, and that what's good for NARGA is good for Metcash.

MR REITZER: Perhaps it's best with an example. Let's use the issue of plastic shopping bags. The implementation of plastic shopping bags or another one would be the whole issue of unit pricing. If those went in a way that were favourable to independent retailers, that would benefit our independent retailers, so presumably they would sell more or have lower costs or something, so they would be stronger, and yes, Metcash would be strong as a result of that. But it's actually got absolutely nothing - directly it's got absolutely nothing to do with us if unit pricing goes in or doesn't or if there's a ban or a levy on shopping bags or not. But if it's done in a way that doesn't damage independent retailers, it will benefit us directly.

THE CHAIRMAN: Can I deal with the area that this enquiry is concerned with, which is competition laws and competition structures and put it to you that NARGA be almost totally funded by, not totally but almost totally funded by Metcash - - -

MR REITZER: The majority.

THE CHAIRMAN: - - - in putting representations to Government as representatives of the independent grocer sector is really just a front for Metcash.

MR REITZER: I disagree with that because they are chasing a whole lot – not a long list but they're chasing an agenda. One of them is competition law reform and where they have certain suggestions, they have executives that say certain suggestions at Metcash because we're in the same sector of the industry. That definitely doesn't make them a front for Metcash.

THE CHAIRMAN: Yes. Would they have an agenda on competition laws that would divert in any way at all – diverge in any way at all from that of Metcash?

MR REITZER: No, not that – if I could just ask you, trading hours are not part of competition or that's a State based - - -

THE CHAIRMAN: Well, it's part of competition laws, it's part of competition policy, yes.

MR REITZER: There might be a divergence of views there, yes.

THE CHAIRMAN: In the sense that they would?

MR REITZER: They are arguing for the trading hours to be left as is. If there were trading law reforms, we've got certain very big stores that would benefit and we've got smaller stores that would – could possibly lose to an .....   It doesn't matter to Metcash.

THE CHAIRMAN: So, to come back to the proposition I was putting to you, NARGAs interests in competition reform are the same interests as those of Metcash?

MR REITZER: Other than the trading hours, yes, but more specifically to trading acquisitions, yes.

THE CHAIRMAN: And so that if NARGA is putting a proposition forward on competition reform, while ostensively it may be putting it forward as the representative of the independent grocery sector, which has a very convenient attraction in terms of representing smaller business and the like, is it not true that what it's really representing is a large multi billion dollar company called Metcash?

MR REITZER: No. It's not so you're representing Metcash. It's representing their members but - - -

THE CHAIRMAN: Whose interests are inextricably woven with those of Metcash?

MR REITZER: Yes, Commissioner, that's the exact same point that I was going to make and that's the problem from a publicity point of view whilst it can be viewed like that because really, we're in a total partnership with our independent retailers and what's good for them is good for us and vice versa. And if anyone stands up on either side of the fence or representing both parties and says something, it immediately looks like their the mouth piece for the other party. That's not the case. We're trying to look after our sector of the industry so that we can be a stronger competitor out there.

THE CHAIRMAN: Yes. It's a partnership though, isn't it, of two, that is, the independent grocer on the one hand and Metcash on the other where one party is earning the money and the other party says, openly in public forum, is not earning any money?

MR REITZER: I disagree.

THE CHAIRMAN: I'm just quoting Mr Cummings, that's all.

MR REITZER: I disagree with that statement and Metcash actually prides itself and all the people, including myself, in Metcash pride themselves of being very close to our retailers and we spend a lot of time with them and I must be perfectly frank that this is the first time I've heard a proposition like that come from any one of my retailers and I'll follow it up because there's got to be some misunderstanding there.

THE CHAIRMAN: Well, yes, you may wish to refer to the public comments of Mr Cummings in the evidence he gave us on 9 April in Canberra.

MR REITZER: Yes, I will.

THE CHAIRMAN: Thank you.

MR O'DONOVAN: So, if NARGA were to, for instance, lobby for more transparent charging by Metcash so that there weren't all these confidential rebates or was to lobby for more freedom for independent retailers to pursue direct sourcing from manufacturers and laws that prohibited aspects of Metcash's arrangements which lock them in, would you continue to fund NARGA?

MR REITZER: Yes. I would engage them on each and every one of those topics and have discussions and try and find a win/win on each and every one. Try and understand what the issues are, why they want that, why it's erased or why it's arisen and I would engage them and try and find a win/win, like I've done for ten years. I mean, there's nothing that we can force on our retailers so we would try and engage a win/win and ..... forward on each one of those topics if they raise them as an issue with us. But - - -

MR O'DONOVAN: Sorry, you say there's nothing you can force on your retailers?

MR REITZER: Yes.

MR O'DONOVAN: So, you're saying that if retailers expressed the view that they wanted actual transparent charging and knowledge of supply terms, you would agree to, rather than having all these - - -

MR REITZER: No, that's not what - - -

MR O'DONOVAN: - - - list of 33 confidential terms that you wouldn't force that situation on them and introduce transparent pricing of your services?

MR REITZER: No, that's not what I said. What I said, if that was risen as an issue, I would sit with them and find a way through that.

MR O'DONOVAN: All right. But it's not true that you can't force things on them because there have been complaints about the lack of transparency in the pricing.

MR REITZER: Complaints to Metcash?

MR O'DONOVAN: Yes.

MR REITZER: I think the three times or three or four times that Franklins raised it, it wasn't a complaint because we asked them, "Do you have any specifics?", so, I mean, "Can you give us" – maybe there is a mistake and they said no, they just wanted to check to have piece of mind. So, we organised the auditors to check it and then in ten years, I think I'm aware of two or three other cases where through various other bodies, independent retailers have approached us and we've got them to sign confidentiality agreements, either as an organisation or a banner or individuals and we've taken them through it. I'm not aware of any other instance where it's ever been risen with me or whether it's been risen with a regulatory authority and then they've queried us.

MR O'DONOVAN: Sure. But going back to your original statement, you can't force anything on independent retailers. That's just not true, is it?

MR REITZER: It is true.

MR O'DONOVAN: That you say your position in the market doesn't dictate to retailers how they will deal with you?

MR REITZER: Everyone's got a choice what they can do with their business.

MR O'DONOVAN: Yes but there reaches a point in their investment, in their relations, when their need for stock to run a business that you can actually make demands of businesses.

MR REITZER: I don't think so because if any of the things that we were so called forcing that need the retailer to be unprofitable or low growth or whatever it is, they wouldn't do it. So, if we went and said, "Your service fees were two per cent from tomorrow to six per cent", then that's my version of forcing. If we went to a retailer and said, "Guess what, we've got a new supplier chain in fresh and you will buy all your fruit and vegetables from them", we can't do that. You earn the right to do that, so we don't force anything.

MR O'DONOVAN: All right. But there are some people who you do require to buy through Metcash?

MR REITZER: Yes.

MR O'DONOVAN: Okay. So, there are things that you can force your customers to do?

MR REITZER: Some of our customers have obligations to us because of a whole myriad of reasons and then they are obliged to do certain things. The alliance agreement is an agreement between two parties and then there's a whole lot of obligations on the retailer if they sign the alliance agreement to do things. If they don't like it, they give us three months notice and they're gone and we lost out as a result of that. So, we can't force them. There's always a .....

MR O'DONOVAN: All right. But if they do – well, they may pay a very heavy price if they chose to depart?

MR REITZER: Have to take the signs down, which inevitably we do.

MR O'DONOVAN: All right. Well, let's return to the proposition which we started with which is that if independent retailers ask NARGA to lobby the government for laws that would prevent Metcash from preventing them from pursuing alternative sources of supply or to lobby for changes that forced Metcash to have more transparent pricing, are you saying that notwithstanding – well, firstly, would you agree that neither of those propositions are in Metcash's interests?

MR REITZER: The first one's not necessarily not in Metcash's interests because all that would happen is Metcash wouldn't help retailers then and that would hurt retailers. So, if there was a law passed that said I wasn't allowed to ask for and have a supply agreement if a retailer needed extra credit or wanted a loan, so I wouldn't give it and the retailer would be hurt. And if there was law that said I couldn't have a supply agreement to cover the term of a head lease that we had signed so my board would not allow me to sign head leases anymore and retailers wouldn't get those sites. So, in that case, yes, it would hurt Metcash. In terms of the argument for more transparent pricing, we would have to engage the retailers to explain what the issues are in terms of confidentiality with the chains, who are their enemy.

That's how we would sort that out but if there was a law passed that did that and damaged Metcash, we would shut down tomorrow. We would declare insolvency tomorrow and we would wipe out several thousand family - Australian business families in Australia if a law like that would pass. We wouldn't have a business left and the decline would be dramatic and then Australian consumers would have two places they could shop.

MR O'DONOVAN: Okay. So, the short answer is that neither of those propositions would be in Metcash's interests?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. And if NARGA were to lobby for them, you still say that – notwithstanding that they're lobbying on what you say now, for a proposition that would lead to Metcash's insolvency, you would still fund them, is that your evidence?

MR REITZER: No, my evidence is that I would assume that if either of those were a topic for NARGA, so if the members said, "Go and do this on our behalf", that we would be the first port of call. That our relationship would be such that they would come to us and engage us on it and after, let's say, three or four months we didn't find a win/win situation they then turn to authorities and said, "Listen, we've been to Metcash" they said, "No, no, please pass a law", chances are in that instance, the relationship would break down because it would be a few months before Metcash declared insolvency.

MR O'DONOVAN: All right. So the upshot of that is that, as a practical matter, if NARGA attempted to lobby for any of those things, Metcash would stop funding NARGA.

MR REITZER: If we couldn't find a win-win in between.

MR O'DONOVAN: All right. Now, as I understand both your and NARGAs position, that the problem with competition in the retail market in Australia is that Coles and Woolworths have too big a market share.

MR REITZER: Yes.

MR O'DONOVAN: Okay. Now, in the last five years the independent sector has grown by 9 per cent. Is that right? From 11 per cent to 20 per cent?

MR REITZER: Yes.

MR O'DONOVAN: Okay. So that, certainly, there's nothing about the market structure that prevents the independent sector from growing in terms of market share?

MR REITZER: Market structure. Yes, there is. Access to sites, restrictive covenants on leases that don't allow us to enter certain shopping centres, creeping acquisitions that allow our independent retailers to be cherry-picked or each store to be picked off like that, and then there are many things that prevent zoning laws, many things that prevent our growth – further growth in market share.

MR O'DONOVAN: Okay. So how many – putting aside leases and restrictive covenants, putting aside those issues and just focusing just on access on sites, how many sites have you acquired, or have independent retailers or Metcash-supplied retailers opened in the last year?

MR REITZER: 55.

MR O'DONOVAN: 55. Now, is that more or less than Coles?

MR REITZER: I think it's more. I'm not sure, but I think it's more. I think they opened 25 or 26.

MR O'DONOVAN: And is it more - - -

MR REITZER: I'm not sure of that number, so - - -

MR O'DONOVAN: All right. And is it more or less than Woolworths?

MR REITZER: I don't know the Woolworths number.

MR O'DONOVAN: Okay. All right. Now then, in terms of – if we just take IGAs, there are 1384 IGAs. Is that right?

MR REITZER: Yes.

MR O'DONOVAN: Which is more than, or close to double the number of Coles or Woolworths?

MR REITZER: Yes, but, with respect, that's not a valid comparison, because they're not all 4500 square metre supermarkets.

MR O'DONOVAN: Okay.

MR REITZER: And within the 1380-odd stores there are many, many IGAs, many Expresses, many Friendly Grocers that are small stores. It's not a – you can't compare the numbers.

MR O'DONOVAN: Sure. Okay. But it's fair to say that IGA has a lot of sites where they could potentially – from which they could potentially provide competition.

MR REITZER: No. The competition just comes from stores above 1000 square metres, of which there are 50 FoodWorks above 1000 square metres. We provided it to the ACCC and I think it's about 350 IGA stores that are above 1000 square metres.

MR O'DONOVAN: Right. So, in total, about 380?

MR REITZER: Yes. Plus, minus.

MR O'DONOVAN: Yes. All right. But if we go down to those smaller format stores, is there any specific reason why those stores couldn't provide decent price competition?

MR REITZER: Yes. There's – they just don't have the space to carry the range. They don't have the space to do the fresh. I mean, fresh uses up a lot of space. And because of their mix, because their fresh mix isn't that high, they can't be cheaper on dry packaged groceries, and their cost of doing business, their cost of supply is high because it's small drops. They're a totally different kind of a business to a fully-fledged supermarket with a full range that carries 18,000 SKUs.

MR O'DONOVAN: Sure. So just going back to the packaged grocery answer, is the reason that they can't provide competitive pricing on the packaged groceries because of the sliding scale fees that they have to pay to Metcash so that - - -

MR REITZER: No, that's a - - -

MR O'DONOVAN: - - - they don't have a sufficient volume.

MR REITZER: That would be a tiny piece of it. The reason is, they have to make a living out of just that mix of goods that they have. So they don't have 12 per cent of their sales in the butchery at a 48 per cent margin. They don't have 15 per cent of their sales in fruit and veg at also about a 38 per cent – gross margin, I'm talking. They don't have those, so all they have is the try groceries, and, therefore, they can't afford to be very cheap on the dry groceries, and our competitors are exactly the same. You don't get the same offer in terms of all the values and prices in a Shell Express – a Coles Express than you do in a big Coles supermarket, and they pay the same price.

MR O'DONOVAN: But if they could get dry groceries cheaper then they could be competitive in those smaller spaces?

MR REITZER: No. I think – I mean, they would have to be a lot cheaper, would be my gut feeling.

MR O'DONOVAN: All right. Now - - -

MR REITZER: Could I go back to that for one point, if I may, just trying to explain? In order to be – for a small store, in order to be competitive, they have to execute the 3 to 4000 SKUs on the Super IGA promotional program. So what we would have to do to – if we wanted to – say they said to us, "Please, tomorrow we want to be competitive." The only way we could get them competitive is to take the promotional program of Supers and apply them to an IGA Express. They don't even carry 3 to 4000 SKUs, and it means more than everything they sell would be on promotion. You can't make money like that.

MR O'DONOVAN: All right. So would it be fair to say that there is nothing that this grocery inquiry can do that will ever make those kinds of stores price competitive, such that the price of groceries fall to consumers?

MR REITZER: No. I don't think there's anything you can do.

MR O'DONOVAN: Okay. So there's no point trying to find some government measure that might prop up these stores, or give them some special advantage over Coles or Woolworths. That will not ultimately lead to any improvement in retail return, retail pricing for consumers.

MR REITZER: No, because that would be cross – that would be like subsidising one piece of the market. I don't believe so.

MR O'DONOVAN: Okay. All right. Now, I want to move on to the code of conduct for the sale of supermarkets. Are you aware of the code?

MR REITZER: Yes.

MR O'DONOVAN: Okay. Now, this was put in place to provide an orderly sales mechanism for the sale of independent supermarkets when the vendors wish to sell them. Is that right?

MR REITZER: That's correct.

MR O'DONOVAN: Okay. And the purpose was to allow both – well, all three of Coles, Woolworths and Metcash to at least have an opportunity to know that the supermarket was on the market, and have an opportunity to make a competitive bid.

MR REITZER: Everyone. Yes. Franklins, ALDI, everyone.

MR O'DONOVAN: Okay. And so it effectively provides a framework where all of the potential buyers agree not to lock an independent supermarket in to, I suppose, a right of first refusal to them, or an exclusive right to negotiate kind of clause, before the others are aware that it's on the market.

MR REITZER: Where a store is put up for sale, yes.

MR O'DONOVAN: Yes. Okay. All right.

MR REITZER: Okay.

MR O'DONOVAN: Now, firstly, in general terms, have you had any issues with the operation of the code?

MR REITZER: My understanding of the code and the way we have implemented the code is when a store becomes available. So it's that when a store becomes available that you don't use any of the things that you're aware of. I wouldn't be in a position to say whether that's been 100 per cent adhered to by all the parties or not.

MR O'DONOVAN: I'm only talking about you. Has it been adhered to by you?

MR REITZER: To the best of my knowledge, yes. When stores become available and we hear from retailers that they want to sell them, we ask them if we can please bid, and we tell them that they – you know, free to get other bids, and we try and find out what the other bids are and beat them.

MR O'DONOVAN: All right. Now, there's an exception in the code which applies where a party has provided financial or other assistance to an independent supermarket operator. Are you aware of that?

MR REITZER: Yes.

MR O'DONOVAN: Okay. Now, the only party that could – realistically, in the real world, the only party that is likely to have provided financial assistance is Metcash.

MR REITZER: But FoodWorks also have rights of first refusal with their – I think with some of the – I'm not exactly sure, but with some of their unity agreements.

MR O'DONOVAN: Okay. Are FoodWorks party to the code?

MR REITZER: I don’t know. I’m sorry.

MR WATSON: Believe so. Believe so.

MR O'DONOVAN: All right. But it’s not going to be Coles and Woolworths anyway - - -

MR REITZER: No.

MR O'DONOVAN: - - - that have provided finance. Okay. Now, how often has Metcash relied on a financing agreement or credit for stock agreement or some other similar agreement to obtain a first right of refusal on a site?

MR REITZER: I’m afraid that’s the same question as the supply contracts. I would have to go and add them up.

MR O'DONOVAN: Okay.

MR REITZER: It would be – yes, it would be a lesser amount.

MR O'DONOVAN: Right.

MR REITZER: And was it part of the supply agreement? Not necessarily, no.

MR WATSON: No, they’re separate documents.

MR REITZER: No. It’s a separate document. I’d have to go and add them up.

MR O'DONOVAN: Okay. All right. And in terms of order of magnitude, it would be above 10 per cent?

MR REITZER: Yes.

MR O'DONOVAN: Okay. All right. And the effect of – and are these just first rights of refusal?

MR REITZER: Sorry?

MR O'DONOVAN: Are these just first rights of refusal requirements that you take?

MR WATSON: Sorry? What – can you clarify that?

MR REITZER: I think some of them are first and last.

MR WATSON: Yes. Yes. There are some first and lasts, yes.

MR REITZER: There are some firsts and lasts, and there are some that are only first.

MR WATSON: Yes.

MR O'DONOVAN: Okay. All right.

MR WATSON: Sorry. Sorry, just to clarify something. You said, “Are they only first rights?” Were you only referring to rights deeds, or – I don’t quite know what you were – I didn’t quite understand the question.

MR O'DONOVAN: Well, I was just asking how often Metcash placed clauses that – in their finance or other assistance agreements, which attracted some kind of restrictive right on – which imposed some restrictive obligations on the sale of the site.

MR WATSON: Right. Yes, that’s - - -

MR O'DONOVAN: Yes. All right. So it’s about 10 per cent of cases. All right. So how many in the last year would you have exercised?

MR WATSON: Sorry. Sorry.

MR REITZER: No.

MR WATSON: No. That’s not quite correct. What I believe Mr Reitzer said was that we would have to go and look it up.

MR O'DONOVAN: Yes. Sorry. Sorry. No. Yes. No, no. I understood that.

MR WATSON: Okay.

MR O'DONOVAN: All right. Now, in the last year how many sites would you have obtained as a result of the benefit of one of these clauses?

MR REITZER: Result of a benefit? Somewhere between eight and ten.

MR O'DONOVAN: Okay. And would any of these areas have been in areas where there was no competition from – no presence for a Coles of a Woolworths?

MR REITZER: I can’t remember. I wouldn’t know that. Can’t remember.

MR O'DONOVAN: Okay. All right. But if what the Bureau of Infrastructure and Transport and Regional Economics says is right, that in places where there’s only an independent and no chain, the consequence of that arrangement has been that Coles and Woolworths have been kept out and consumers are worse off. Would you agree with that proposition?

MR REITZER: If there's only one supermarket in the area, yes, they – I would imagine they're worse off. They don't have choice.

MR O'DONOVAN: No, no. But they're worse off because it's retained as an independent, which makes higher profit margins when not faced with competition, as opposed to Coles or Woolworths buying the site and pricing closer to their national pricing.

MR REITZER: The assumption there is that they do that.

MR O'DONOVAN: Well, that's what the Bureau of Infrastructure and Transport and Regional Economics found.

MR REITZER: Yes.

MR O'DONOVAN: So, if they're right, that is the consequence, isn't it?

MR REITZER: I think the way the line of the question is going is a very, very small probability of that happening. So what would have had to have happened is that there would be a Super IGA store above 1000 square metres - because those are the only ones that the chains buy – in an area where there's no chain present, who asked us for assistance, or we signed the head lease or something, and as part of that negotiation we have got a first right of refusal – first and last right of refusal – and then one of the chains would have come and made a bid to buy the store, and we would have said, "No. There's the money," and then we would have on-sold it another independent. I can't think of anyone like that.

MR O'DONOVAN: All right. But you'll look?

MR REITZER: Yes, certainly.

MR O'DONOVAN: Okay. That's all I have got on the code.

THE CHAIRMAN: Yes. Just before we move off that particular topic, going back to that voluntary code of conduct again, when Mr O'Donovan put a question to you about restrictive arrangements I think Mr Watson was potentially narrowly interpreting the question as relating to first and last rights of refusal. I want to just widen that a bit and ask you this: are there any of your arrangements with your customers which would impose an incentive, or a disincentive on them to deal with other than Metcash if they wished to sell their business? I could give you an example in a moment, but I'll perhaps leave it open.

MR REITZER: If there's a supply agreement.

THE CHAIRMAN: Yes. Yes.

MR REITZER: So if, for example, we had a supply agreement and it had three years to run, and they wanted to sell their store to someone that wasn't going to honour that supply agreement, we would ask for it to be paid out.

THE CHAIRMAN: Right. Now, when you say "ask for it to be paid out," the voluntary code of conduct talks about restrictive covenants that provide for a return of any investment that's been made with a fair return on that investment. In other words, that there be bona fide arrangements in place. So that if, for example, you have assisted by the provision of $500,000 for store fit-out, that you'd be entitled to get back the – what's the word? It's the unamortised amount of that $500,000 and no more. But do any of your agreements provide for you to get back something in excess of that unamortised amount?

MR REITZER: To the best of my knowledge, no, and I can only recall – it was a long time ago. It was like, about, seven or eight years ago, there was one retailer where we had a supply agreement, and he was insisting, and then we did a calculation of – there was so much volume left, and our EBIT would be on that, and we had – you know, "We have advanced you so much money, so that" – I can't remember the exact – that's how the calculation was done. But there was no – for example, we didn't say, "Well, if you sell the store you have got to give us $500,000 for breaking the contract." There's nothing like that.

THE CHAIRMAN: Okay. Thank you.

MR O'DONOVAN: That's all I have got public.

THE CHAIRMAN: Public. All right. That's the end of the public hearing, and we'll move in to confidential submissions. Thank you, members of the public and the media, whoever might be there, but that will be the end of public hearings, and you'll probably be relieved to hear that's the end of public hearings on this inquiry, I think.

ADJOURNED **[2.32 pm]**

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