Public hearing – Melbourne

26 May 2008

Internal ACCC lawyers assisting– Mr Damien O'Donovan & Ms Catherine Freeman

Time: 10.00am – 5.00pm

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

Room: Level 35, opposite reception

Time (indicative only)	**Witness**	**Legal representation**	**Submission**	**Summons**
10.00am	Coles Group Limited **Mr Mick McMahon** Chief Operating Officer **Mr Terry Bowen** Finance Director – Coles **Mr Tim Boyce** General Manager – Coles Property **Mr Cameron Trainor** General Manager – Coles Grocery Merchandise **Mr David Stevens** General Manager – Coles Fresh Merchandise	**Ms Elizabeth Pilgrim** Coles Counsel **Mr Dave Poddar** Mallesons Stephen Jacques	No. 157 on ACCC website	No
1.00pm – 2.00pm approx	*Lunch*			
2.00pm – 5.00pm	Coles (cont)			

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ABN 72 110 028 825

Level 10, MLC Court, 15 Adelaide St BRISBANE QLD 4000
PO Box 13038 George St Post Shop BRISBANE QLD 4003
Tel:1300 308 420 Fax:(07) 3503-1199
Email: orders@auscript.com.au Website: www.auscript.com.au

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: 10.06 AM, MONDAY, 26 MAY 2008

THE CHAIRMAN: Well, good morning ladies and gentlemen. I think in the spirit of competition, the numbers present here today about equal those of those present at the Woolworths hearing the other, although you probably have slightly less representatives at the table, but that's all right. My name is Graeme Samuel. I'm the Chairman of the Australian Competition and Consumer Commission and the Chair at this public inquiry into the competitiveness of retail prices for standard groceries. I welcome you all and declare this hearing open. I'm joined by Commissioner John Martin on my right and Commissioner Stephen King, who are the other two presiding members for this inquiry.

The inquiry is convened under part 7A of the Trade Practices Act. It's held pursuant to a request made on 22 January from the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Minister Chris Bowen. Details regarding or matters to be taken into consideration by the inquiry are available on the ACCCs website. I note that we have received so far over 200 public submissions to the inquiry as well as confidential submissions. These submissions cover a broad range of issues and the ACCC will endeavour to take into account all relevant information that has been provided.

The purpose of these hearings is to give the ACCC an opportunity to investigate in detail, the key issues that have been raised. We have held hearings through Australia during April and May with the remaining hearings being in Melbourne. I wish to emphasise the many witnesses that have attended hearings over the past two months did not attend voluntarily and were summonsed to appear under section 95S of the Trade Practices Act. In particular we summonsed all supplier companies, therefore no conclusions can be drawn regarding a company's willingness to participate in the inquiry from the fact that a company appeared at the hearings.

Now, some of the material covered in today's hearing with Coles will be confidential and commercially sensitive and therefore parts of the hearings will not be open to the public. This is because we must be able to investigate issues without damaging the witnesses' competitive position or commercial relationships. We'll also be questioning Coles about confidential documents that we have obtained through our information gathering powers that obviously can't occur in public. Transcripts of the public parts of the hearing are available on the ACCCs website. We may disclose some aspects of the confidential components of the transcripts some time after the hearing, if we consider that some of the material should be in the public domain. But we will consult with Coles before doing just that.

In terms of procedural issues, all Coles' representatives will have a procedure document that outlines how we intend to approach these hearings, so I won't go through the procedural points in detail. I just with to emphasise that although we're not taking evidence under oath at this hearing, it is a serious offence to give false or misleading evidence to the ACCC. In relation to confidentiality, if Coles believes that a particular question or a series of questions are likely to result in the disclosure of confidential information, then Coles should indicate an objection to answering the question on that basis. I will then consider whether the inquiry should take evidence in private.

I note that although we're not using external counsel at this hearing, witnesses will be questioned by the ACCCs internal lawyers, Mr Damien O'Donovan and Ms Catherine Freeman. That concludes my preliminary remarks. I thank all the Coles representatives for attending the hearing today. We realise that you are busy people and attending is a significant imposition on your organisation. Could I perhaps ask you, for the record, to identify who you are so that our transcript can perhaps identify, you know, who the individuals are and perhaps start with yourself, Mr McMahon, and then we'll sort of run along the table.

MR M. McMAHON: Yes. Thank you, Mr Chairman. I'm Mick McMahon, Chief Operating Officer for Coles. Perhaps start down here, David.

MR D. STEVENS: Yes, good morning. I'm David Stevens, I manage Fresh Merchandise.

MR C. TRAINOR: Good morning. I'm Cameron Trainor, I'm the General Manager of Grocery Merchandise.

MR T. BOWEN: Good morning. Terry Bowen, Finance Director for Coles.

MR T. BOYCE: Good morning. Tim Boyce, General Manager of Property for Coles.

THE CHAIRMAN: All right. And then we have got five other representatives who, just again for the record, if we could have those starting with - - -

MS E. PILGRIM: Yes. Elizabeth Pilgrim. Internal legal counsel, Coles Group.

MR D. PODDAR: Dave Poddar, external legal counsel.

MR C. MARA: Chris Mara, Corporate Affairs.

MR T. MOORE: Ted Moore, Retail Consultant.

MS P. McGILLIVRAY: Pauline McGillivray, Project Coordinator.

THE CHAIRMAN: Thank you. Mr O'Donovan, hand over to you.

MR McMAHON: Mr Chairman, I have a very brief opening statement, if I may?

THE CHAIRMAN: Yes. Mr O'Donovan, we'll sort that, we'll take, we'll take it through that, we'll - - -

MR McMAHON: Okay. Thank you.

MR O'DONOVAN: All right. Just before we begin, I just need to confirm that each of the people giving evidence today understands that it's an offence under the Criminal Code to give evidence at this inquiry that the witness knows is false or misleading or omits any matter or thing without which the evidence is misleading. And I would just ask each of you to confirm that you understand that, just by saying yes in turn.

MR McMAHON: Yes.

MR STEVENS: Yes, I understand.

MR TRAINOR: Yes.

MR BOWEN: Yes. I understand.

MR O'DONOVAN: All right. Now I understand you have an opening statement?

MR McMAHON: Thank you, Mr O'Donovan. Thank you, Mr Chairman, for the opportunity to appear as part of the ACCC inquiry into grocery prices today. We believe Australians enjoy a grocery market that delivers high quality products to customers at affordable prices across a choice of brands and locations, and we believe that's the result of a competitive market. Existing and new competitors are growing. Customers are seeking more choice than ever before and as a result are better informed and more discerning about their grocery and fresh food choices. And the Coles brand has a long history dating back to 1914, since the first store was opened in Collingwood in Victoria and today we're a national network of 749 stores.

We employ over 92,000 Australians within supermarkets and we serve several million customers every week. In November 2007, Coles was acquired by Wesfarmers Limited, which is another great Australian company. As a leading supermarket retailer we recognise the important role we play in providing our customers with quality products at affordable prices they can trust, especially at a time when household budgets are under pressure and food prices are subject to inflationary pressures from both global and domestic sources.

Coles delivers competitive prices to customers, as was demonstrated by the results in the most recent independent price survey conducted by Choice. In 2007, Choice found Coles to be the cheapest national grocery chain in each of the 23 regions surveyed across Australia. In the past 12 months, we have contained the prices of everyday products such as bread, milk, eggs, bananas, chicken and bacon to minimise price rises for our customers. Over the last six months, for example, we have passed on less than a third of the price increases we have experienced in the cost of our house brand milk. We also source competitively priced products that are alternatives to well known brands through our three tiered range of house brands, Coles Finest, You'll Love Coles and Coles Smart Buy.

Our house brands offer customers genuine savings and great quality, often generating competition in product categories where there has previously been limited choice for customers. Having said all this, we recognise that for all our strengths as a business, we cannot take our customers for granted and we don't. If we don't provide the quality, value and choice our customers expect, they will and do go elsewhere. With the support of our new owner in Wesfarmers, we're excited about the opportunity to improve our offer and look forward to exploring new ways to attract and retain our customers, including the introduction of unit pricing. Coles supports transparent pricing so that customers can make informed choices.

We already display unit pricing across a range of products in our stores, including deli, dairy and other fresh product categories. Our view is that unit pricing will benefit customers, and while we would prefer to see this adopted universally by all supermarket and food retailers across Australia, Coles will introduce unit pricing, and we expect to be able to do so over a period of about 12 months and at a cost of up to $10 million. In addition, Mr Chairman, Coles values and recognises the importance of its relationships with growers and suppliers and seeks to negotiate fair and transparent terms.

In keeping with this, we comply with mechanisms designed to protect the interests of suppliers and growers, including the Produce and Grocery Industry Code and we have our own internal complaints resolution processes. We deal direct with our suppliers, for over 85 per cent of our fresh produce and we have enjoyed long term relationships with a vast majority of them. Our view is that the Horticulture Code incorporates dispute resolution procedures which merit the Produce and Grocery Industry Code and while we are reluctant to be involved in two separate codes, we would support the development of a single code that ensured a standard and transparent approach to commercial dealings for all participants in the market. Thank you, Mr Chairman, and we look forward to assisting you in the course of the day.

THE CHAIRMAN: Thank you, Mr McMahon.

MR O'DONOVAN: Right. Now, just for my benefit, I might start by asking each of you must to indicate how long you have been with the company, because I understand things have changed a lot since Wesfarmers took over and that would be helpful just in working out how much historical information we're likely to be able to get.

MR McMAHON: Yes. It is very correct to say there's been a lot of change in Coles, not only in recent times. I joined Coles three years ago and came into the supermarkets business just over 12 months ago. Again, David, do you want to - - -

MR STEVENS: Yes. I have been with Coles for three years now and probably more recently in the fresh food side than the last year or 18 months.

MR TRAINOR: Yes. I have worked for Coles for 27 years, starting in stores.

MR BOWEN: Six months, previously with Wesfarmers.

MR BOYCE: And just on 14 years, in property the whole time.

MR O'DONOVAN: Okay. All right. Now, to begin with, would it be fair to say that there has been a fair amount of gloom, at least in the previous 12 months or perhaps prior to the Wesfarmers' takeover, about the performance of Coles in the supermarket market, would you accept that?

MR McMAHON: No, I wouldn't accept gloom. I think that Coles has not lived up to shareholder expectations, which is one reason why the business is now in new ownership. And I think we have a lot more work to do with our customers. But I would say that we still have nearly 100,000 people working in our stores every day, who are very committed to what they do.

MR O'DONOVAN: Okay. So you accept that there has been some, I suppose, disappointment at least at the shareholder level with the performance of the business?

MR McMAHON: Yes. I would say the operational performance of the business, and we're on the public record as saying that there is a lot of work we need to do to improve it and I guess our focus is looking forward rather than looking back.

MR O'DONOVAN: Sure. Okay. But even despite that sense, it's fair to say that the business is still strong and the supermarket and liquor business contributed, I think something like half a billion dollars in net profits. Am I right in those sort of numbers for last year?

MR McMAHON: The business, in terms of the specific numbers, is probably slightly more than that, in terms of the reported numbers for food and liquor. Yes, and we would say that when you run a business of 750-odd stores across the country, we still have to get a lot of things right everyday in order to meet our customers' needs. So I guess that performance is a relative thing and we believe that we have more improvement to go.

MR O'DONOVAN: Right. Okay. So it's more by comparison with Woolworths that people, I suppose, see Coles as a struggling business, do you think?

MR McMAHON: Well, I'm not sure if they see it as a struggling business. Again, we first of all look at it through the eyes of our customers, that's what we're focused on every day. And I think relative, not just to Woolworths, but clearly Woolworths are a strong competitor. But ALDI are expanding their network at a significant rate and IGA are doing similar. So we don't just look at it either just through the competitor lens and if we are looking at competitors, we don't believe it's just Woolworths.

MR O'DONOVAN: Okay. All right. But the Coles business, the supermarket business itself remains profitable and strongly profitable, you would agree with that?

MR McMAHON: I guess it comes back to your definition of strong. And the supermarkets business in terms of a number of financial measures, we still have a long way to go to get to the sort of territory that we would like to be in. But it remains a profitable business, yes.

MR O'DONOVAN: Okay. All right. Well, then let's – I suppose let's look at one of those measures which is mentioned in the Coles' first submission to the Commission and that's the return on funds employed. Now, it's fair to say that the return on funds employed, which is effectively I suppose the amount that you earn on the investment, is still very strong for Coles. If you take a three year average it's more than 30 per cent probably?

MR McMAHON: Well, I might ask Terry to comment on the specifics of a return on capital. But I would just say a couple of things. First of all that the return on capital measure for supermarkets is before you get to things like interest and other measures. Secondly, there's one fundamental difference in this marketplace, compared to so many other markets in the world and that is that over 97 per cent of our properties are leased. And that gives you, if you like, an artificially inflated return on capital because we only own therefore, by definition, almost 3 per cent of our freehold properties. If you adjust the return on capital for the leasehold effect, the return on capital comes down significantly to more what you would expect in this sort of a business. But, Terry, do you want to comment on the specific return on capital measure?

MR BOWEN: Yes. Thanks, Mick. It's correct what Mick's just alluded to. I think the other thing that's worth taking into consideration is historically those assets were valued obviously at cost and then depreciated over time so there'll be a degree of depreciated assets within the cost space that may still be functional but, if you like, having no asset value. And probably a more relevant measure now is close to acquisition our return on capital is a very different number to what you would be looking at. Given, if you like, the market price which has now been paid for this business and obviously the returns that it's now generating.

MR O'DONOVAN: Sure. But still the return on funds employed does give you an idea of, I suppose, the power or value of the investment in a large format supermarket. That's in terms of the returns that are possible. Would you agree with that proposition?

MR BOWEN: Yes. At a holistic level, I think that's a reasonable statement. I think it's been relevant to look at the returns of the business today on a, if you like, a fully costed organisation which has now obviously come about through the subject of the sale.

MR O'DONOVAN: Sure.

MR McMAHON: So I think the key point, if I could – it's really about the replacement cost of that capital and adjusting for lease costs. We don't make a new supermarket investment expecting that sort of return. We get that sort of return on a limited measure because of the depreciated nature of the assets.

MR O'DONOVAN: Right. But it is true to say that the return on funds for Coles is higher than they could get for deploying them almost anywhere else, in terms of - - -

MR McMAHON: No, I don't believe that's true at all. And in fact our shareholders – or the previous shareholders of the Coles Group didn't find that that was an acceptable return for the reasons that I outline. At the end of the day you can't invest direct into the supermarket fleet, you invest into the company that owns it. And the return on capital or the return to shareholders was obviously not acceptable. And we make investments now with a view to what I would call the more normal return on capital. And the Wesfarmers' benchmark is in the order of 18 to 20 per cent, for example.

MR O'DONOVAN: Yes, but that's as a shareholder, obviously. But if it were possible for there – if we just isolated the supermarket market in Australia, and looked at large format supermarkets as an investment, we can see Woolworths last week told us they were returning something like 75 per cent of funds employed. On the same metric, Coles is returning about 30 per cent which, if it were possible to enter that market easily, that would be attracting investors. Those are very attractive returns and investors would be able to do that.

MR McMAHON: Well, I think – sorry - if the assumption is that you can invest easily and make 30 per cent return, I think it goes without saying that that would be a very attractive investment. What we're flagging is that you can't, that that number reflects the depreciated nature of the assets. Anyone entering does not pay the depreciated value, they pay the market value of those assets today, in which case the return on assets at Coles supermarkets falls below the benchmark that we would like.

MR O'DONOVAN: Sure, but if barriers to entry were low in the Australian supermarket market, people wouldn't have to invest in Coles or Woolworths, they could simply enter into a lease in the same way that Coles and Woolworths do and set up a large format supermarket and generate the sorts of returns that Coles and Woolworths currently enjoy. That's if barriers were low.

MR McMAHON: Well – and we might argue that barriers are low and exactly the scenario you describe is occurring now. We have ALDI virtually doubling store numbers in the last couple of years. I read with interest in the press that they have ambition to build a very large network in this country. We have the likes of Metcash ..... Super IGA and other formats also growing. FoodWorks etcetera. So I would agree with your statement, but I suspect it's happening already.

MR O'DONOVAN: Right. But it – well – so firstly, would you say that ALDI – would you regard ALDI as a direct competitor?

MR McMAHON: We certainly regard them as a direct competitor on the range that they stock. So ALDI stock, in terms of direct comparison to us, around 800 to 1000 lines. They tend to be the high volume lines that drive customer traffic. And we very much see them as a competitor on that range.

MR O'DONOVAN: Right. But only in respect of the, I suppose, the budget brands that you offer rather than the mainstream brands?

MR McMAHON: Well, you have got to be careful possibly with the term budget brands, but certainly we line up Smart Buy products and You'll Love Coles products competitively against ALDI, and we try to make sure that we deliver at least as good a value to our customers. But it's also true to say that ALDI stock, you know, a wider range of products, and customers are drawn to them for that. In other words, more general merchandise and apparel and other products.

MR O'DONOVAN: Okay. But it is true to say that, firstly, in terms of format, ALDI represents a much smaller market entry than – they're not entering the large format supermarket market? You'd agree with that?

MR McMAHON: They're a very different business model, absolutely agree. All I'm flagging is that, if you look at it in the eyes of the customer, which is the way that we do, our customers make a choice where they're going to spend their money each week. And certainly for those with a little bit of time, they're quite prepared to shop around and go to ALDI. And what we can't afford to do, as a large format national brand offering full range and full service, we can't afford to lose too much of the high volume fast turn products that customers want. So we very much see them as a competitive threat, and we respond to them in that way, and our customers benefit as a result.

MR O'DONOVAN: But it's true to say that they haven't entered that large format, one stop shopping space that Coles and Woollies occupy?

MR McMAHON: That's correct.

MR O'DONOVAN: Okay. So – and in terms of recent competitive entry, there really isn't anyone of any substantial scale that's been able to enter in those size supermarkets above two and a half thousand square metres?

MR McMAHON: I think that is an accurate statement, yes. All I'm flagging is, with the likes of ALDI, with the likes of Metcash and, indeed, with over 30,000 small specialist retailers, you've got to be careful about defining the offer or the format through the size of the store. You know, a small fresh produce merchant outside the front door of our supermarket is a significant competitor for us in respect of fresh produce. And if you look at it through the eyes of our customers, they will compare the price, the quality and the range of that offer against us. So we believe that competition doesn't just mean large format.

MR O'DONOVAN: All right. But then just returning then to return on funds employed. If it is possible to earn the sorts of returns – 30 per cent for Coles and 75 per cent to Woolworths – in the large format supermarket context, the fact that we haven't seen entry into that part of the market does suggest that there are barriers to entry preventing that direct head to head competition in a very lucrative proportion of the market. Would you agree with that?

MR McMAHON: Well, no, I don't. I can't comment on Woolworths' returns, and I think we have already adequately responded to the point about return on capital which, after you adjust for lease and remove the fact that your denominator is the depreciated value of the assets, I think the returns being generated from this business, including if you take other measures like our EBIT margin, our EBIT margin has, you know, some way to improve. We're currently at the low end of international benchmarks. So I think if you look at a range of financial measures, I don't see this as particularly lucrative. Obviously we think it's a good business or we wouldn't be in it. But it's not an easy business to make returns.

MR O'DONOVAN: All right. So you wouldn't say that the sorts of returns on funds employed that Coles and Woollies enjoy, you wouldn't accept the proposition that that's evidence that the Australian market for the large format supermarkets is pretty benign competitively?

MR McMAHON: Absolutely not.

MR O'DONOVAN: Okay. All right. Now, you have indicated that one of the reasons why these returns on funds employed are seen, at least to an outsider, extremely good, is that you rent premises rather than own them?

MR McMAHON: Correct.

MR O'DONOVAN: So you don't have to deploy large amounts of capital?

MR McMAHON: Correct.

MR O'DONOVAN: All right. Now, that fact, in itself, is due, in no small part, is it not, to your ability to attract developers as an anchor tenant. So it's your existing power in the marketplace that enables you to not have to deploy capital into that – obtaining appropriate sites and securing them on very favourable terms for long periods. Would you agree with that?

MR McMAHON: Well, I understand your point, but I'm not sure I'd follow that logic train. First of all, let's be clear that this is a market heavily dominated, if you like, by the landlords, the shopping centre landlords, for all sorts of reasons which other people can probably comment on better than me. In terms of our position in that, we are an attractive tenant. We do bring customers and foot traffic to those centres, and that benefits not only the landlord but, as I say, a range of smaller specialist players. Over 30,000 of them around the country. Not all in shopping centres, but a large number of them are. And that drives a particular set of economics, if you like, around shopping centres. The second thing though, I think was implicit in your question, is that we get attractive rates. What we are doing is signing up for a long length of time. Often up to 20 years. Tim can comment on the detail better than me.

That the base rent which tends to be quoted is only one element of the rent we pay. After that there's a turnover rent. The other smaller specialist players who may be also in those shopping centres are more typically on a short term lease, and more typically, if you like, perhaps on a single dimension rental. I don't really know the details of the specialist – the construct of their rental. But the point is that we're there for 20 years with a base rent and a turnover rent, and that's the way the economics work.

MR O'DONOVAN: Sure. But if we're to just break it down to say per square metre level, there is an – there's no doubt that Coles, on a per square metre basis, at least, gets substantially better terms than the equivalent speciality shop outside that's competing with it?

MR McMAHON: On a – if you look solely at a per square metre basis and you don't look at the length of the contract, the amount of the financial commitment over 20 years and the risk we take, then what you said is correct, yes.

MR O'DONOVAN: Okay. And, in fact, the length of the lease is a substantial advantage to Coles in that it has security of tenure in sites that it regards as attractive, and so - - -

MR McMAHON: Yes, I believe it's attractive obviously both to the shopping centre landlord and to ourselves, yes.

MR O'DONOVAN: Sure. And from a speciality retailers point of view, the fact that they only have a five year lease, in fact, exposes them to higher risk that, when rent is renegotiated, they won't be able to obtain attractive terms.

MR McMAHON: It's probably a question for them, but it depends on the nature of their offer. And you might argue that a smaller player with a narrow offer signing up for 20 years is taking a very big risk. So I'm not necessarily sure if it follows.

MR O'DONOVAN: All right. But anyway, at least from Coles point of view, the rental terms that is offered, for whatever reason, are attractive in, at least, two senses. One is that they, on a per square metre basis, are lower than the other stores with which they compete outside.

MR McMAHON: Yes.

MR O'DONOVAN: And also they are for a long term which gives you a security of tenure to invest in that business in an attractive site.

MR McMAHON: Yes, the only thing, as I say on the second point, is that long term can be a double edged sword but, nonetheless, I understand what you're saying.

MR O'DONOVAN: Okay. And the further commercial advantage is you don't need to deploy capital to obtain a site – to secure a site for a long term investment in a large format supermarket?

MR McMAHON: Not the freehold. Obviously we fit out the supermarket which is still a significant capital investment, but not the freehold.

MR O'DONOVAN: Sure. Okay. Now, if we compare that scenario to the scenario that independent – sorry, actually I'll take it back a step. So in addition to that, obviously another major expense in setting up a supermarket is stocking the shelves. And our understanding is that Coles currently enjoys negative working capital, is that right?

MR McMAHON: No, I don't believe that's right as we sit here now. Terry, do you want to comment on working capital?

MR BOWEN: I think in a pure definition of working capital, that's correct, but within that working capital definition there is employee entitlements, and there's other provisions at a Coles level, for instance, provision for restructure obviously with the organisation going through. If you strip out cash days and concentrate just purely on the debtors that you're owed or moneys that you're owed, the inventory that you have got on the shelves, and the creditor payments that you enjoy from your supply terms, and you consider just the cash days effect of each of those, then cash – sorry, Coles, for period of time now, and certainly in the six months that I've been with the business, has a cash usage requirement. And it's – so it's not fair to say that – I think it's fair to say there's a negative working capital, but potentially the innuendo that you may derive from that, saying that there's - somehow we're funding that through creditors, is actually incorrect when you look at our cash days.

MR O'DONOVAN: All right. Well, let's focus on the – in terms of the inventory on Coles shelves, at the point in time when a consumer buys a product, will there be a gap in favour of Coles between when they have to pay for the product the consumer buys and when the consumer pays for it? In other words, will Coles have already paid for the products that a consumer buys at the check out? Obviously on average, in terms of – in terms in which these things can be measured, are consumers buying something that Coles has already paid for, or does Coles retain the benefit of that payment for a couple of days before they're obliged to pay the supplier?

MR BOWEN: So in answering the question again, based on our current performance, which extends back at least another 12 months that I'm aware of, Coles has paid for that inventory before we get the money from our, if you like, customers at the moment through the check out.

MR O'DONOVAN: Okay. And what's the – how many days is there then between - - -

MR BOWEN: Depending on the month it varies somewhere around three to six days.

MR O'DONOVAN: Okay.

MR BOWEN: So there's some cyclicality in that.

MR O'DONOVAN: All right. So it's – but it's a relatively short period of time?

MR BOWEN: Yes, that's true.

MR O'DONOVAN: Yes, all right. So the – now, if we were to look at an independent supermarket looking to set up in competition on a large format basis, firstly, our understanding is that they have not been attractive tenants to landlords. Would you agree with that or?

MR McMAHON: Well, I don't think we're in a position to really agree or disagree. Certainly I would say that Coles is a very attractive tenant to landlords, and I'll leave others to judge the answer to your question.

MR O'DONOVAN: All right. Well, then perhaps this, again, may be a question that you're not in a position to answer, but in terms of where an independent supermarket's ability to obtain goods on a basis where it doesn't have to pay for them until only a couple of days before they're bought, that independent supermarkets don't have that same ability that Coles has?

MR McMAHON: Well, I think it's fair to say it depends on the business model. So, although ALDI is a limited range offer, we would say that they have come in here, they have their own supply chain arrangements, it's 100 per cent house brand, it's very competitive. I think when you move across to other competitors and, again, you should really ask them these questions, but if you move across to some of the IGA – the Super IGA supermarkets – particularly the likes of Foodland South Australia and Ritchies in Victoria and so on – they're big large format, very formidable competitors, and they're obviously able to generate that offer somehow. One thing I would say though is that, for somebody trying to set up, if their only opportunity was to source product through the wholesale channel, then I would be concerned on their behalf in terms of their ability to compete. But I don't think that's an issue for us. I think that's an issue about how competitive or not the wholesale sector is in this country.

MR O'DONOVAN: But – so that is a disadvantage that you would recognise is there?

MR McMAHON: I think if I – perhaps I can answer it this way. If I was a new entrant trying to set up, I'd be wanting to make sure that I could source competitively a priced product, both in terms of the unit price and the trading terms that go with that. And I wouldn't want to be doing it through the current wholesale arrangements in this country.

MR O'DONOVAN: Right. Okay. So in those – so you'd be prepared to accept that the current wholesale supply options for independent supermarkets don't leave them in a position to compete directly on price with Coles or Woolworths?

MR McMAHON: No, I wouldn't be that absolute because, as I say, we have a mix of competitors out there. The larger format, Super IGAs, for instance. I mean, a Foodland in South Australia is very competitive. What we would say is that some of the smaller format stores around the country price higher than either Coles or, we believe, our larger competitor. So we believe that when Coles is in an area we will bring lower priced products to customers than some of the likes of IGA.

MR O'DONOVAN: And that's because IGA can't secure wholesale product at competitive terms?

MR McMAHON: Well, that would be a question for them. All we see is the result at the end of the day, which is that, you know, they are priced above us in general – as a general statement.

MR O'DONOVAN: Okay. All right. Now, in terms of the – you mentioned Foodland in South Australia. Is it true to say that, in terms of their ability to secure sites, it's because of their willingness to acquire shopping centres rather than obtain them on a rental basis?

MR McMAHON: Yes, I have to say that we look more at Foodland from - in respect of a competitor and what offer they're putting in front of the customers, because our customers will be looking at that as well. Tim, would you know enough to comment on that or?

MR BOYCE: Probably not. I mean, whilst on occasions they might – pardon me – they might take the direction of securing a freehold opportunity, I don't think that that's the generic nature of the way that they go about securing opportunities.

MR McMAHON: It's not something that we notice anyway, put it that way.

MR O'DONOVAN: All right. But there are cases in South Australia where Coles is a tenant of a shopping centre that's actually owned by the owners of the competing supermarket?

MR BOYCE: I think there's one or two examples of that, but I wouldn't know them off the top of my head.

MR O'DONOVAN: Right. Okay. All right. So the – would you accept that – but from that discussion, would you accept the proposition that, even before we look at how well run an independent supermarket is, it's at significant structural disadvantages in terms of setting up a competing offering to Coles or Woolworths?

MR McMAHON: No, I don't, and I think you've got to be a little bit careful of what you're considering in that question. One of the advantages that having a business of the size of Coles brings, is that we bring economies of scale which ultimately benefit customers. We run 749 stores, I think it is today, across the country. We have the scale of supply chain behind that to be able to put fresh and high quality product in front of customers every minute of every day. We negotiate direct with some of the world's largest multi-nationals in terms of the FMCG, or fast moving consumer good, players. Without that scale I'm not sure how somebody else could bring the sort of pricing that we bring to customers every day.

MR O'DONOVAN: Sure, but just going to – I suppose going to structural matters, which is not to say that they're not – they haven't been legitimately acquired over the course of the business. But in terms of the structural advantages which both Coles and Woolworths enjoy, that make it difficult for competitive supermarket entry in that large format, you have better access to, I suppose, cheap rental opportunities, you've got better access to lower wholesale prices, and you've got better access to advantageous to supply terms. Would you agree that those are three key elements that make it very difficult for a large format supermarket to enter?

MR McMAHON: No, I don't. I think what we have is established brands and customers who want to shop with us because we've built up that brand and that trust over nearly 95 years. In terms of access to preferable terms, I don't believe that the terms are preferable at all. I have explained earlier that the length of the tenure, and the base rent which you quote, plus a turnover rent, means that we're paying certainly our fair share of rent. I do agree there's benefits in scale. That's what I've said. And that a new entrant starting, as per any new entrant I think in any industry, would struggle with that scale.

However, I would come back and say that it depends on your business model. And we have seen an example of IGA, who have a very different business model. They don't try to compete across 27,000 products that we stock on our shelves. They compete head to head on the thousand high volume lines. But as we flagged, we can't afford to lose sales on those high volume lines. Secondly, they compete with a business model which is virtually 100 per cent house brand, which gives them an advantage. And IGA themselves are a very large multi-national player who bring their scale to bear.

MR BOWEN: I think that's ALDI.

MR McMAHON: Sorry, I should've said ALDI instead of IGA. Apologies.

MR O'DONOVAN: All right. But just in terms of your access to premises where you suggest you didn't feel there was any special advantage – I mean, the truth is that if a Westfields or a Stocklands is building a centre they are going to call Coles and Woolworths. They're not going to call a Super Barn or a Foodland or a Ritchies to anchor that store.

MR McMAHON: That's probably a question for them, but I think they would prefer Coles and Woolworths, yes, for the scale advantages that I've described.

MR O'DONOVAN: Sure. So would you accept that that in terms of your ability to secure attractive sites in areas where there are populations to sustain supermarkets, would you accept that that is a significant structural advantage that Coles and Woolworths enjoy?

MR McMAHON: Yes, and I think it is an advantage of our scale is the point and the fact that we can put an attractive offer for customers, which includes low prices, and it means that we can act as a draw to those shopping centres. That's what's behind it. I don't think it is – well, that is what is behind it now the - - -

MR O'DONOVAN: Yes. No, no, I'm not questioning whether or not that is sound or not sound commercial judgment.

MR McMAHON: Sure.

MR O'DONOVAN: But, nonetheless, the effect of it is to entrench Coles and Woolworths as the dominant players in that large supermarket format.

MR McMAHON: I'm not sure I necessarily agree with your conclusion. I think we've seen over the last 12 or 18 months what happens if you don't get the offer right for customers every minute of every day and in particular the BI-LO conversion I think is a good example. I mean this market has a much higher percentage of customers who switch between brands than any other market that I've personally worked in and it's a market that's driven by strong promotional programs, by customers who make a choice literally every week about where they're going to do their shop and I think Coles knows better than anybody else what happens if you don't get that offer right for customers; customers go elsewhere.

MR O'DONOVAN: Okay. But in terms of where they go, if they're looking for a large format one stop supermarket there is one alternative and that's Woolworths; you agree with that?

MR McMAHON: No, I don't because – in terms of large format I'd still come back to the – if I call them the Super IGAs, so the larger format IGAs around the country, and again I don't think that you're really looking at it in the eyes of the customer because - because of the cross shop that occurs in this country, because of the phenomenon where customers are quite happy to buy their staples, if you like, their groceries with a Coles, but they may buy their produce from a Toscanos, who's out the front, or their chicken from a Leonard's Chicken or their bakery products from a Baker's Delight and many of these players are sitting either in the same shopping centre or in the high street outside our door. So I think if you look at it in the eyes of the customers there's plenty of choice in this country.

MR O'DONOVAN: There is obviously competition for the particular – you've indicated coming from ALDI in relation to the high volume stockkeeping units.

MR McMAHON: Sure, yes.

MR O'DONOVAN: But they stock less than 1000; is that right?

MR McMAHON: You'd have to ask them that, but in terms of the ones that we see as a real competitive challenge to us, it's around 800 to 1000 that we make sure that we're price checking, that we're very much across what they're doing on those products, about 800 to 1000 lines.

MR O'DONOVAN: Okay. Whereas a Coles Supermarket would – a large format would have about 27,000?

MR McMAHON: On average around 27,000 products.

MR O'DONOVAN: Is that the number you gave?

MR McMAHON: Yes.

MR O'DONOVAN: All right. And the only other competitor in the market who would offer that range is Woolworths?

MR McMAHON: I can't comment on – certainly they do. I can't comment on how many products a Super IGA would carry, but I'd be surprised if it was much different to that.

MR O'DONOVAN: Okay. But at least – but in terms of your earlier comments you indicated that their ability to obtain competitively priced SKUs through the wholesale market is limited in Australia?

MR McMAHON: Yes, again I'd probably keep it at a general level about the opportunities at a wholesale level being somewhat limited. Obviously Super IGAs manage to do it somehow because they put a very good offer in front of customers.

MR O'DONOVAN: Sure. That suggests in terms of price competition, just looking at the intensity of price competition across the 26,000 SKUs that someone like ALDI doesn't stock and that aren't offered by a specialty store, you and Woolworths have – well, the competitive dynamic is really between Coles and Woolworths.

MR McMAHON: Yes, but I think if you take your answer – sorry, your question, just take it in pieces. I think you said that the products that ALDI don't stock and that aren't stocked by specialists, I'm not sure there are too many of them. There's over 30,000 specialists and independent retailers in this country. As I've said, it's somewhat of a phenomenon, this marketplace, in that regard, and certainly if you take fresh – if you take meat and if you take bakery, and I could keep going. So there may be some lines which are only stocked by Coles and Woollies, but it's certainly not something that is top of my mind or top of our mind; we are competing with everybody out there every day.

MR O'DONOVAN: Sure. But in terms of price, and just focusing on price, that if you can keep yourself competitive with Woolworths that is probably sufficient in the marketplace?

MR McMAHON: Definitely not. If you take – I've mentioned a Foodland in South Australia or a Ritchies – if you take a number of the fresh produce operators, I think butchers – you know, meat sellers and so on, it's a very competitive market across the board. That's why we made sure that we're competitive at a local level, because at the end of the day our customers are making choices at a local level and they're comparing prices, not just against Woolworths, but they're comparing them against ALDI or IGA, whereas I keep coming back to, the specialists out the front.

MR O'DONOVAN: All right. Now, you mentioned Foodland as someone who you would keep an eye on. They presumably would – presumably you would understand that they obtain their dry groceries from Metcash?

MR McMAHON: That's my understanding, yes.

MR O'DONOVAN: Yes. All right. And given your assessment at least of their ability to obtain – let's concentrate on dry groceries at a competitive price, you would not expect them to engage in any undercutting in dry groceries, would you?

MR McMAHON: I do expect it; not only expect it, I see it quite often and, as I've said, in South Australia they're a formidable competitor. I'm not privy obviously to the – how they are supplied and what those arrangements are, but one way or another they seem to put a very competitive offer on the ground.

MR O'DONOVAN: Sure. But are you suggesting that if we were to look at – not looking at specials or promotions or anything like that, but the standard shelf pricing of the 26,000 SKUs offered in a large format supermarket, that we would see evidence of undercutting by independents against Coles?

MR McMAHON: I think, yes, against individual stores or individual operators, yes, there would be some of that. Obviously we do our best to stay on top of that and make sure that we are putting a competitive price in front of our customers on every line, but from time to time that will occur and we very quickly follow and meet that price.

MR O'DONOVAN: So if we were to obtain data about how local markets are operating, that we would – are you suggesting that we would see a local competition effect from an independent undercutting a Coles or a Woolworths?

MR McMAHON: Yes, but you would see multiple steps to that. First of all, you know, we believe that our offer is competitive or only competitive as per the choice of a – we were seen as the lowest priced supermarket in 23 regions across Australia. However, there will be from time to time, you know, large-scale independents like the examples we've used who do put a more competitive price out there and that's why our store managers have the responsibility and the authority to drop their prices to match them on a range of over 330 everyday products which tends to be the battleground if you like.

MR O'DONOVAN: So if the Commission were to decide that it wanted to improve competition in the market, one way of doing it would be to assist large format independents to secure entry into local markets; would you agree with that?

MR McMAHON: No, I think I would have to leave that up to the Commission. My comments earlier were really about being careful when thinking about how customers ultimately benefit and how they ultimately benefit from lower prices, and having a lot more small stores out there I don't think will necessarily deliver lower prices to customers. I would agree with you on that point.

MR O'DONOVAN: Sure. But if we were to assist independents to secure sites for large format supermarkets in local areas, that would have a positive effect in terms of pushing down prices?

MR McMAHON: Well, I think we'd keep it at this level. We have no problem with competition; we're set up to compete every day and we're happy to compete with anybody. The only thing I would say is that we would like to play on a level playing field and to make sure that we can all compete on the same basis.

MR O'DONOVAN: But in a market where there is reluctance on the part of landlords to approach independents to set up these kinds of supermarkets, would it be a reasonable intervention in the current structure of the market to find some way to assist more competitive large format independent supermarkets into an area and would it have the effect of lowering prices and increasing competition?

MR McMAHON: Well, I think there is an important dimension that is being missed there, which is the customer. If I could put it this way, which is to exaggerate a little bit to make the point, but if you impose a brand and offer on supermarkets in an area which they don't want, and they don't shop, you haven't achieved anything. So ultimately in these things I think you've got to go forward to the customer. What the customers want is a range of choices. We believe they have it today.

We believe that large operators like Coles bring scale which allow us to put very competitive prices in front of customers every day, which smaller – so that's our objective every day that we operate this business. At the end of the day it's not so much – well, it's not only about the location, you have to have the offer, you have to have the brand. You have to get the execution right in the stores and imposing that on customers is not something I'd recommend.

MR O'DONOVAN: But what I understood you to be saying in relation to at least the large format independent offerings like Foodland in South Australia, that customers have embraced it, that it's a good offering and it does put pressure locally on Coles and Woolworths.

MR McMAHON: They're certainly a formidable competitor and we pay attention to them absolutely and I think customers benefit from that. But I'm not sure that it necessarily follows into your other point. Competition is not only about price, competition is about range, it's about quality of product, it's about the service that you provide and it's also about location and, you know, we have many competitors out there who seem to be doing just fine on all of those fronts.

MR O'DONOVAN: All right. Now, moving onto a different topic.

MR McMAHON: Sure.

THE CHAIRMAN: Before we do that, I just want to carry this through a bit further if we can, just go back on some of the discussion we've been having. We've been using terms like return on funds employed and the like and you'll have been aware, I'm sure, of the discussion we had last week with Woolworths on return on funds employed. Perhaps, Mr Bowen, you might be able to assist us, because I just want to be sure that we're talking about the same language; that is we use interchangeably return of funds employed, return on investment, return on capital employed, and do you see – and Mr McMahon has talked about various elements of that in the context of leasing and the like which I perhaps want to challenge this in a few moments, but do you see the expressions as being interchangeable?

MR BOWEN: I think to the large part, Mr Commissioner, you're right. Return on capital, return on funds employed, in my experience, without knowing exactly how Woolworths might term their funds employed, most organisations I've worked for have a very similar definition.

THE CHAIRMAN: And I thought that is the answer you would give. So that what we are looking at is some evidence given last week by Woolworths that its return on funds employed had moved over the past five years from about 52 per cent to about 76 per cent and in the context of Coles we're talking about return of funds employed around the 30 per cent mark, although it has varied over the past three or four years, but it's of that sort of order?

MR BOWEN: That is correct and I think it just – it's actually declined in the last few years.

THE CHAIRMAN: Yes, that's right. Now, return of funds employed, as Mr McMahon has pointed out and you've pointed out, is very much dependent upon a range of factors; that is how much capital are you actually employing in the business. It also, of course, depends on the expense associated with it. I'm not sure, Mr McMahon, going back to my days of investment banking, which are going back some time I have to admit, that it ought to make a great deal of difference to whether you're actually investing in the real estate or you're actually paying leasehold expenses to someone else. One way or another it is a pure financing exercise. So I'm just trying to understand the importance of substituting a leased premises for a premises that you actually purchase and pay for yourself. Would you like to just take us a bit further on that?

MR McMAHON: Yes, sure. Well, if I make a couple of points and then Terry, please answer. First of all at an absolute financial level you're absolutely right, it shouldn't make much difference. Obviously you're not engaging in leasing unless you think it's going to work for you.

THE CHAIRMAN: Correct.

MR McMAHON: Or in some cases we don't have a choice, that's the offer that we have. Secondly, though, it goes back to your point about definitions and all we're flagging is that when numbers like 30 per cent – I can't really comment about 75 per cent – but when numbers like 30 per cent are quoted they are not adjusting and that's in the definition of what adds up to 30 per cent. And we can perhaps do this a couple of different ways. One is in confidence we can take you through our view of what the numbers are or after the event we can provide some information back to you to try and illustrate that point.

THE CHAIRMAN: Well, perhaps we may need to do that, but I just want to sort of throw a couple of propositions to you just in terms of that particular statistic of return on funds employed, because return of funds employed will reflect a range of factors or a – it will reflect lower working capital.

MR BOWEN: That's correct.

THE CHAIRMAN: Or in the case of Coles perhaps, relative to Woolworths, a higher level of working capital because of the creditor and sales relationship.

MR BOWEN: That's correct.

THE CHAIRMAN: So that would be one element. The other element it will reflect will be the extent of depreciated assets.

MR BOWEN: That's correct.

THE CHAIRMAN: Now, depreciated assets is always an interesting issue because businesses are generally able to operate with significantly historically depreciated assets if there’s not a great deal of challenge on them to invest in new assets, and that always – not always, but invariably occurs where there is a lack of a competitive challenge to require investment in new assets. Now, would you accept the proposition that that may well be part of the explanation for the relatively high return on funds employed for Coles? I mean we would all love to have return on funds employed at 30 per cent or thereabouts?

MR BOWEN: I think you’re right, that is potentially a conclusion you can draw. The other conclusion you can draw is that you have a short-term focus in relation to results achievement which ultimately are not for the sustainable good of the business, so you can choose to not invest even though you should be investing and ultimately see a deterioration of your business over – a potentially pronounced deterioration over a period of time which is really a symptom of not investing when you should have in the first place and that is around trying to keep short-term measures up, such as EBIT and return on funds employed in an environment where you should actually be investing in your business.

THE CHAIRMAN: So it’s a perhaps a combination of short-term focus and at the same time lack of competitive pressure to actually invest or perceived lack of competitive pressure to invest, because if I can get a return on depreciated assets that is a far better circumstance than having to invest in new assets, then try and get a return on that, that at least will exceed what my current return on funds employed will be?

MR BOWEN: You are again exactly correct but I think the two major symptoms from my – from certainly my experience, the degree to which you perceive the competitor threat versus the degree to which you are just playing for short-term gains, I think needs to be balanced in the context of the decisions of the day.

THE CHAIRMAN: All right. Well, now, let me just put a couple of scenarios to you if I can, and I’m perhaps getting a bit ahead of Mr O’Donovan doing just this, but – so forgive me if I do. Pull me up if that is the case. But what we’ve got here is relatively high returns on funds employed for a number of the reasons that we’ve just discussed. We’ve got EBIT margins which are published which are at least acceptable, although in terms of relative to the competitor – I say the competitor there to compare to Woolworths – are lower and there’s clearly an indication in public statements by representatives of Coles, they’d like to see their EBIT margins increased. But in terms of worldwide international comparisons the EBIT margins of Coles are, I think, on any analysis at least relatively good, if not the best. You might rather than just nod might say yes and just help the transcription.

MR BOWEN: Sorry. I think they’re relatively okay, versus – I don’t know that we would be putting them in the best.

THE CHAIRMAN: Okay.

MR BOWEN: Because again, EBIT margins will come down to the degree to which you capitalise leases and a lot of overseas, kind of, benchmark levels have got a high property ownership. So therefore return on funds employed or EBIT margins aren't directly comparable. And that's so, I think if you adjust as best you can for like for like, Coles is satisfactory versus world benchmarks, but certainly nowhere near the best.

THE CHAIRMAN: Now, we have also got evidence that's come before us in previous hearings that – I'm going to lay out various elements to this for you because it does suggest that there is not a high level of competition coming from the other supermarket chains, with the exception of Woolworths, and these are the factors that Mr O'Donovan has been pursuing this morning. For example, it has been apparent to us, subject to challenge by you, that ALDI is much less a competitive force than it is a complimentary force. Now, that's reflected by the fact that ALDI has about 800 to 1000 different units that it sells, compared to, I think, 27,000 that Coles or Woolworths would sell.

And indeed the fact that it's been evident from evidence given to us by landlords that Coles and Woolworths have now indicated much less objection to having an ALDI store in a shopping centre, in fact their preference would be to have it in the shopping centre rather than outside the shopping centre. So I'm putting those propositions to you and let's just test them as we go along.

MR McMAHON: Sure. Well, if I take the two parts to that. The first one and I would come back to we really need to be careful about how you define competitor and we look at it through the eyes of the customer. And if you walked in some of our stores which are in locations with ALDI, you'll find people who are quite happy to go into ALDI and stock up on a number of products and then come to us, if you like, to complete the shop. And they may also be going to the local butcher and that's a phenomenon of this market. They are serious competition in that regard, let me assure you.

And the sorts of competitive effect that it's had is to make sure that we're introducing a lot of house brand products, Smart Buy and so on, which lowers the price points available to customers, so lowers the prices available to customers and makes sure that we are at least as competitive as them. Secondly, in respect of would we prefer to have them 5 kilometres down the road or in the shopping centre. If you follow that customer logic through, I would rather have them attracting customers to the shopping centre. And that's actually true, by the way, whether it's ALDI or anybody else. You would rather have them there generating customer traffic and then give us the chance to compete and bring those customers into our stores.

THE CHAIRMAN: Right. And I think you have given the answer I expected, which is that in respect of the products that consumers are prepared to buy in generic brands – house brands – ALDI will be a competitor. And then you say that they complete their shop in your supermarkets which will be for the branded products?

MR McMAHON: No.

THE CHAIRMAN: And maybe fresh fruit and vegetables and the like.

MR McMAHON: Okay. But I would say it's quite often for the fresh product and it's quite often for the extended run. So, you know, ALDI won't carry such a wide range of health and beauty products or health foods. And the only thing I would say is that they tend to be the more complex range with slower turns and we can't afford to be left just majoring in those product lines. If I could make that point. We must compete on those high volume core lines. And that's why ALDI are a very serious competitor.

THE CHAIRMAN: Now let's look at the competitive tone, I think offered by the so called independents, the IGAs and related. Those supplied by Metcash. And how many super IGAs have we got in the country?

MR McMAHON: I couldn't tell you the number. But I can really just tell you that the Foodlands, the Ritchies, I can tell you the brand names. We may be able to dig out the number.

THE CHAIRMAN: Yes, a bit in South Australia. But elsewhere, fairly remote? We would be talking less than 200, I think?

MR McMAHON: ACT – well, I don't have a number in my head. We can find one for you.

THE CHAIRMAN: We can find that out, yes.

MR McMAHON: Sure.

MR BOYCE: It's in excess of 400.

MR McMAHON: In excess of 400.

MR BOYCE: Super IGAs.

THE CHAIRMAN: And now let's look at a couple of other factors which are again on the public record. We have got the BITRE survey which has indicated the one least recently published, which indicates that wherever Coles and Woolworths enter a market, there are low prices. But in the absence of Coles and/or Woolworths, there are higher prices which is suggesting that the IGAs or other independents are generally at a higher price than what Coles and Woolworths are charging. You're familiar with the survey obviously?

MR McMAHON: We are. But the first thing it suggests to us is that we bring lower prices in and competitiveness to the areas where we have a store. I have also highlighted that you have got to be careful, I think, to understand what brings value to customers. And one of the things that brings value to customers is scale in our supply chain, in our ability to negotiate on behalf of our customers with some of the world's largest companies. So I think all of those are factors which says that some of the small stores out there, the small IGAs and others, do struggle to complete on price.

THE CHAIRMAN: Yes.

MR McMAHON: And it's another reason, if I can just go one point further, why we strongly believe in opening up trading hours in places like Western Australia, because when we're closed because of restrictive trading hours, our customers have little choice but to go somewhere else and pay 10 or 12 per cent more than they would pay with us.

THE CHAIRMAN: And that's an interesting response in that you're suggesting that the IGAs are not providing a price competitive tension, that the competitive tension is being provided by Coles and Woolworths. But that the IGAs, for a number of reasons whether it's in Western Australia relative to trading hours as you put, or in other areas, are not providing a true competitive tension to Coles or Woolworths?

MR McMAHON: Well, I think, again as I have tried to do all the way through, I differentiate between – and I'm no expert on IGA – but, I differentiate between the smaller IGA and the super IGAs, which I think are, you know, quite a different proposition. And I think the other thing that we do need to bear in mind, your question was about price and I think you're right. But customers buy on more than price. Increasingly convenient in Australia, so a lot of customers will shop with IGA because of the convenience associated with it because it's local, because they quite effectively run local community support programmes and the like. Quite often parking is easier in some of those locations when our customers are on the way home from work or dropping off the kids for school. So just to broaden that out a little bit beyond price, that's, you know, it's in the mix where the provide a competitive challenge to us.

THE CHAIRMAN: I didn't want to take – sorry, did I interrupt someone?

MR McMAHON: No, you're right.

THE CHAIRMAN: No. I beg your pardon. Right. So I'll take it one step further and then can come to perhaps a final question and then Mr O'Donovan can resume. But you will have also heard or read that the evidence given by Mr John Cumming of NARGA, National Association of Retail Grocers of Australia, who responded in respect of EBIT margins and the like to indicate that, I think – I don't want to verbal him but I'll try and summarise – that the IGA stores in general do not make a profit. In fact they may well lose money in respect of the products that are supplied by Metcash which are generally dry goods, which again suggests that – this is all adding up to a scenario – that suggests that the independent smaller supermarkets, the IGAs, are not in a position for one reason or another, to provide a competitive dynamic as far as Coles and Woolworths are concerned.

MR McMAHON: I think that's a fairly absolute conclusion from your point. But nonetheless, I understand your point. And the response would be that that's something to take up with Metcash because in the value chain - - -

THE CHAIRMAN: You can be rested assured we will. But I'm just interested in a dynamic that we're painting at the moment of where the real competitive tension for Coles and Woolworths comes from. And I think it would - - -

MR McMAHON: On price, I think you're right.

THE CHAIRMAN: Yes, on price. It would tend to suggest that there is a limited competitive dynamic coming from IGA or those outlets that are supplied by Metcash - - -

MR McMAHON: From the smaller ones. I would agree with you.

THE CHAIRMAN: Yes. Right, but you would suggest that in respect of the larger ones, the larger super IGAs, there is a - - -

MR McMAHON: They're very formidable price competitors as well. And I just reinforce that I'm talking here about the price dimension. The IGAs – I don't wish to do any disservice to them - they provide a very good offer but it's quite a different proposition.

THE CHAIRMAN: Now, you have mentioned the Choice survey that suggests that Coles is the cheapest across a basket of goods in 23, I think, regions.

MR McMAHON: Correct.

THE CHAIRMAN: Your policy. Is it to price at, above or below the prices being charged by competitors in any particular region?

MR McMAHON: Well, there's multiple dimensions to our pricing policy. If I take our approach to normal selling price and we'll come back to promotions and the like.

THE CHAIRMAN: Yes.

MR McMAHON: For normal selling price, we'll set one central price where we can. But our aim is to be competitive at a local level because customers make choices when they are in the shopping centre, whey they're deciding which store to go to. So we want to be competitive at a local level. We therefore within a state, will have a number of pricing zones and more importantly, at the store manager level, they can lower their prices and they must, in fact, lower their prices to match local competition. That's the standard policy, if you like. Then in terms of pricing differently to our competitors, there are a number of factors that come into play.

One is that the store manager can propose back up the line, the need to undercut, maybe to lower the banana price or other products that are important to customers. And the only thing we would say is we put a level of authority around that to make sure that an overzealous store manager isn't doing the wrong thing in respect of local competition. The second thing I would say in respect of pricing being different and why ultimately we win things like the Choice survey, is because our promotional program is set in a way to attract customers, to make sure that we have the best specials in the marketplace.

We have a number of programmes like Rewind out there, where we lower prices for a 12 or 13 week period, where we end up with lower prices than competitors. Our house brand pricing program is structured in such a way that while we at least meet the prices of our competitors, on Smart Buy we aim to be at least the lowest price around, if not the lowest. And on You'll Love Coles, we aim to be at least 10 per cent lower than our competitors. And if I take a few examples of that, it means on things like, you know, a Smart Buy white loaf of bread will be $1.09 up the east coast at the moment and then our biggest competitors are $1.19, as I understand it.

So I could go through a range of examples. Within our Deli we're moving as much as we can to what we call everyday fair price, so instead of a chicken breast being 15.99 one week and every now and then 8.99 on special, at the moment it's at 10.95 and we're leaving it there. And we're seeing fantastic customer acceptance of that and tremendous volume increases. So there are a whole raft of ways which end up meaning that our prices are quite different to our competitors and you can see the results of it in the likes of the Choice survey.

THE CHAIRMAN: So if I can summarise. You're saying then that you're pricing strategy will sometimes or often have store managers lowering prices below that of whatever the competitor might be charging?

MR McMAHON: No. The store manager has the authority to lower prices to match on normal sells across 330-odd products. If they want to lower prices, it's got to come back up the line to the buyer or to the region. Because there have been instances in the past where, as I understand it back in history, where overzealous store managers were being a bit too competitive. And by that I mean that in terms of small players outside the front door, we need to make sure that we're competing in a fair and reasonable way with the small players.

THE CHAIRMAN: And if you lower your price, I think – I forget what you said for a breast of chicken, ten - - -

MR McMAHON: To an average of 10.95.

THE CHAIRMAN: 10.95.

MR McMAHON: Yes.

THE CHAIRMAN: And Woolworths were to lower its price for the same product to $11.50, what would you do?

MR McMAHON: We're leaving it at 10.95. And that's been running, David, probably for 12 months?

MR STEVENS: Yes. It's been running for just over a year. And we were leading the market in that respect for six to nine months in that fashion.

THE CHAIRMAN: Do store managers have the capacity to raise price above normal levels?

MR McMAHON: No.

THE CHAIRMAN: Right. Okay.

MR McMAHON: Sorry, they can – if in the previous week they lowered their banana price to match somebody and now that price has gone up, they bring it up to normal sell. But they cannot raise prices above normal sell.

THE CHAIRMAN: And what about, in terms of matching competition, to what extent are they permitted to sell below cost?

MR McMAHON: They have no authority to sell below cost across any given period of time. If they're matching a competitor they can do that. That, on a weekly basis, will through information back to us in the office, to the buyer in the office and we'll make decisions about that, you know, centrally if you like, to ensure that we have control.

THE CHAIRMAN: Mr Poddar would have been pleased with that answer, I'm sure, Mr McMahon.

MR McMAHON: Well, I can assure that – yes, we'll stick with the answer.

THE CHAIRMAN: Sorry, Mr O'Donovan.

MR O'DONOVAN: Okay. Just two follow up questions then. Just in relation to chicken breasts, presumably Woolworths, based on the policy we heard last week, was that if they're present locally, they would match that price?

MR McMAHON: Well, I think – and David can comment specifically on chicken breasts – but I think we need to differentiate between what I would call normal sell, which is only one dimension of the competitive dynamic. There's the promotional activity, the way we structure our promotions, our move to try and give customers more trust in our pricing by moving to every day low prices, things like Rewind and so on. Now we, you know, adopt the strategy in that regard and our competitors sometimes follow and sometimes don't. David, on the chicken breast example, do you have a specific – how did Woolworths respond?

MR STEVENS: Well, I think from our observation, our standard sale price didn't change, which is what we had intended to do. So to lead out on a standard sell price, our observation was they didn't move their standard sell price to that effect.

MR McMAHON: So in other words, they maintained being high for three weeks and low for one week, instead of us being every day fair price, four weeks.

MR O'DONOVAN: All right. Now, the other point just arising from the Chairman's questions is given what we know about or given what you suspect about the competitiveness of the wholesale supply of groceries to a super IGA, namely that it's not competitive, that makes it really impossible for even a large format super IGA to make a sustained across the range assault on margins in dry groceries. I mean, would you agree with that proposition?

MR McMAHON: Can I just be crystal clear, no. Because I'm trying very hard to differentiate between the small store IGAs. But I would agree with your - - -

MR O'DONOVAN: Yes. No, I'm only talking about super IGAs.

MR McMAHON: For the larger ones, I don't know their arrangements obviously with Metcash. All I can say is that from the prices that they put, you know, in the marketplace, they're able to be competitive, and very much so.

MR O'DONOVAN: Yes. I mean, I don't doubt that they can be competitive but the question is do they – is there any concern from your perspective, they may be able to undercut you on dry groceries?

MR McMAHON: Yes.

MR O'DONOVAN: You think that they may. On a sustained basis and across the range?

MR McMAHON: Not only may, but they do and I'll give you the South Australian example, which is to come back to the BI-LO conversion problem that some of us inherited, which is that a number of BI-LO stores were converted in South Australia and that Foodland for instances, to use that example, took the opportunity to make sure that they were very competitive and that they made Coles pay for the way that that conversion was executed. And I can assure you that they're price competitive every day and every week over there. And more so in those circumstances.

MR O'DONOVAN: I think the witness has indicated they would like regular breaks and that now might be a good time.

THE CHAIRMAN: Right. That suits.

MR McMAHON: We'll leave that to you, Mr Chairman.

THE CHAIRMAN: Yes. Okay. Fine.

MR McMAHON: Thank you.

ADJOURNED **[11.19 am]**

RESUMED **[11.34 am]**

THE CHAIRMAN: Well, I might observe, Mr McMahon, that someone at the Woolworths ..... a rush on dry groceries out there. We've run out of tea and also run out of Tim Tams. So, any way that you can assist us on usual trading terms, it would be very helpful.

MR McMAHON: Stock outs are not good so we'll see what we can do about that, Mr Chairman.

THE CHAIRMAN: All right.

MR BOYCE: Is there a Coles Central downstairs we could get a teabag?

MR McMAHON: There's a Coles Central downstairs. We can go there at lunchtime.

THE CHAIRMAN: I'm advised by my co-commissioner that we've got plenty of biscuits but no teabags, so maybe you could help us out on that. All right. Mr O'Donovan.

MR O'DONOVAN: All right.

THE CHAIRMAN: Sorry, you had a question you wanted to ask.

COMMISSIONER KING: I wanted an answer just before you stated again, Mr O'Donovan. Mr McMahon, I just wanted to put up some of the statements that you made on prices this morning and just to enquire on a bit more depth. I'm going to chose two stores.

MR McMAHON: Sure.

COMMISSIONER KING: And I hope I've got the details right, I'm doing them from memory but I'll pick Jamieson Centre in the ACT and I'll pick Belconnen from the ACT, which is the larger shopping mall. Jamieson Centre, off the top of my head, I think, has Coles and no Woolworths?

MR McMAHON: Yes. That's right.

COMMISSIONER KING: That's correct. Okay. But it does have an ALDI which is separated, I think, by a butcher from Coles. They're almost next door to each other. Conversely, Belconnen, again from memory, I think, has no ALDI but does have a Woolworths and I think the Woolworths and the Coles are all of about 20 feet apart from each other - - -

MR McMAHON: Correct.

COMMISSIONER KING: - - - in that particular centre. So, my first question is this, taking those two examples which are about, you know, probably two or three kilometres apart at the most, would they be in different price zones from Coles perspective because of those different competitive constraints?

MR McMAHON: Well, it's a specific question and we should probably find a specific answer for you but Cameron, would you know - - -

MR TRAINOR: Without the specifics in front of me but we could certainly find out during the break and come back to you.

MR McMAHON: Okay. We'll find out exactly.

COMMISSIONER KING: Why don't we find out during the break and I'll follow up on those questions then later on. I've got a number of questions relating to what sort of prices we would expect to see in those stores.

MR McMAHON: Okay.

COMMISSIONER KING: Okay.

MR O'DONOVAN: Okay. Now, just shifting the focus a bit. In terms of policy, because Coles have a specific policy as to what its competitive response is when the new store opens up or a furbished competitor store reopens in local competition with Coles.

MR McMAHON: Two points to make there. First of all, in general, our overall pricing applies. However, its customary in the industry and certainty that's what we do, to support a new store opening with some strong promotional activity, not necessarily just product and price but there may be marketing activity associated with it and so on. There may be increased catalogue or advertising or there typically would be increased catalogue and media advertising associated with the opening. But in general, we would say around a new store opening, four to six weeks, typically probably four weeks, of promotional activity over and above the national activity to support the new store opening.

MR O'DONOVAN: Okay. So, if there's a new store opened up next door to a Coles store, you would expect, as a matter of course, to see Coles firstly produce a catalogue that was specific for that store's local area, is that right?

MR McMAHON: Well, there are two things there. Our own new store openings, which is primarily what I was talking about.

MR O'DONOVAN: All right.

MR McMAHON: But certainly also combating competitor store openings because they do exactly the same, so the first thing we're trying to do is respond to – I'm talking in general here – but in general, that's what occurs and we would respond with our local store.

MR O'DONOVAN: Okay. So, if – just so I can be clear on the details – so, if a new independent supermarket were to open up next door to a Coles, as a matter of national policy, Coles would then produce a store specific catalogue for that store?

MR McMAHON: Well, in general, to open up against – sorry, to have a competitor opening against us, that is generally the case, we will form a view as to our own competitive strength in that location, how much help we think we might need, you know, how strong is our location in terms of access to parking and, you know, customers getting in and out and all the other factors before you get to line and price promotion.

MR O'DONOVAN: Yes. But in answer to my question, normally when that occurs, when someone you regard as a direct competitor opens up next to your store, you will produce a store specific catalogue for that store?

MR McMAHON: Typically, yes.

MR O'DONOVAN: Okay. Now, in relation to that catalogue, will the pricing be especially keen, like, keener than could be delivered under any other policy that Coles employs in any of its other zones?

MR McMAHON: I think that's typically the case, certainly on at least a number of product lines, yes.

MR O'DONOVAN: Okay. Now, normally, would you expect that there would be below cost pricing of particular items to make them extra attractive to consumers at that point?

MR McMAHON: I think there could well be.

MR TRAINOR: There could well be from time to time.

MR McMAHON: Yes. For a short period of time.

MR O'DONOVAN: All right. And when you say below cost, how do you actually work that out?

MR McMAHON: Yes, well, it's a good question because even in my response I should probably be a little more careful. Obviously, we like to negotiate with suppliers to support that sort of opening, so my response was really, if you took normal cost of goods we may at times, in that sort of activity, be selling at or below. But we work to get support from our suppliers for those sorts of promotions and in general, we're reasonably successful because they're, you know, suppliers are as interested as we are in maintaining our sales. So, the question is what does below cost mean? At the end of the day, we view it as are we selling at a point that's below all the revenues that come in from a supplier and secondly, across our business and across a week or across a month we don't sell below cost.

MR O'DONOVAN: So, if we were to just look at that item, the price of which you were selling it and to take out price support from the supplier, would there be a net contribution to that selling price from Coles, I guess, in financial terms?

MR McMAHON: Well, if we assume no support from suppliers definitely yes, but as I'm saying - - -

MR O'DONOVAN: But if we were to net out the – so, there is support - - -

MR McMAHON: If we netted out - - -

MR TRAINOR: Yes, there would.

MR O'DONOVAN: But even taking into account - - -

MR McMAHON: Yes, there still would be on some product lines, yes.

MR O'DONOVAN: Okay. So, where's there's, effectively, a corporate contribution to the - - -

MR McMAHON: Yes.

MR O'DONOVAN: To the selling price of that item?

MR McMAHON: Yes.

MR O'DONOVAN: Okay. And so then in terms of the period for which that kind of – that individual producing of catalogues with below cost items, how long does the policy allow that to go on for?

MR McMAHON: It's typically four weeks is what I would say.

MR TRAINOR: Yes, it's typically around four weeks and I think the other point we would make is that the majority of the items that we were advertising wouldn't be below cost. The other point I would make is that drawing on - if we've opened or a competitor's opened against us, quite often invariably they would put aggressive points into the marketplace to attract customers to their new business and if we had the same item advertised the following week, we would adjust our price points to ensure our customers knew that we were competitive in the marketplace.

MR O'DONOVAN: Okay. And so this kind of behaviour generally goes for four weeks, what's the longest, say in the last three years that Coles has sustained this cataloguing for after an opening.

MR McMAHON: I couldn't answer specifically but I would say up to six and it may be as short as two and that's, hence, why we're saying typically four.

MR O'DONOVAN: Okay. But in terms of three or six months, would it - - -

MR McMAHON: No, definitely not and even to go to six weeks it would be because perhaps, in some circumstances, we're not getting the customer response that we want. So, we're just going a little bit longer but, no, four to six weeks would be the longest.

MR O'DONOVAN: Okay. Now, you may be aware of what's described as the Birdsville amendment, which is the predatory pricing amendment that went through the Parliament last year, are you aware of that?

MR McMAHON: I'm aware, yes.

MR O'DONOVAN: Yes. Did it make any difference to this practice or any pricing practice which Coles engages in?

MR McMAHON: Well, we're always making sure that we are complying with both regulation and law in that respect and we certainly reviewed the implications of those changes and we believe that everything that we do is consistent with them.

MR O'DONOVAN: Sure. But did it necessitate any changes?

MR McMAHON: Not that I'm aware of, no.

MR O'DONOVAN: Okay. All right. And in terms of if it were to be appealed and replaced with something else, do you think that's likely to make a difference to your behaviour in the marketplace?

MR McMAHON: Not that – we don't believe so, no.

THE CHAIRMAN: Probably a bit difficult unless you know what it's going to be replaced with.

MR McMAHON: Well, that's true but I do hear obviously the political debate around it, so - but you're absolutely right, we don't know exactly what it will be replaced with.

MR O'DONOVAN: Okay. All right. Now, I was going to move on to market share. All right. Now, in terms of market share, you might be aware that as part of its submission to the Commission, Choice, the consumer association, submitted a survey of its subscribers.

MR McMAHON: I'm broadly aware but not familiar with the document, no.

MR O'DONOVAN: Okay. All right. It's at tab 20 of the documents you've been given.

MR McMAHON: Okay.

MR O'DONOVAN: Okay. Now, in terms of the key results, the question that consumers were asked is, where do you mainly do your grocery shopping and 78 per cent of those surveyed shop at either Coles or Woolworths, which is suggestive of a very substantial market share getting close to 80 per cent figure that's often bandied around. Does Coles, internally, operate on the assumption that it has a market share in the order of 36 per cent?

MR McMAHON: No, we don't.

MR O'DONOVAN: No. Okay. What would – dealing firstly with the, I suppose, the grocery market at its broadest, what's Coles assessment of its market share?

MR McMAHON: Well, we report to the market and we report internally our market share which is based around the Australian Bureau of Statistics measure which has, at the last report to the market in terms of results update, we had us about, in February, at about 24.3 or 24.4 per cent and on any measure, we are probably in that 24 to 25 per cent range in terms of market share.

MR O'DONOVAN: Okay. And you don't have access to other sources of information that would cause you to query the ABS data?

MR McMAHON: No, we believe the ABS measure is by far and away the most accurate. It's the most complete. The other measure which is often used and quoted and, hence, in my view the confusion, is what's termed the Nielsen Scan Data and that information is for a limited range of categories only within the store, not even all dry grocery and certainly not fresh, and that continues to distort the sorts of numbers that are reported. We will look at that in terms of tracking our performance in particular categories that are reported, but we don’t look at it from a market share perspective.

MR O'DONOVAN: Okay. Now, are you aware of what I think is described as Homescan Data, where it’s not done at the store level but it’s – data is scanned by consumers when they go home?

MR McMAHON: Yes, as we understand it, yes, Homescan supplements the category information which they receive from retailers.

MR O'DONOVAN: By ACNielsen?

MR McMAHON: Yes.

MR O'DONOVAN: Right. Okay. But again, that’s not data you acquire for your internal purposes?

MR McMAHON: Do you we use the Homescan, Cameron?

MR TRAINOR: Not normally, it’s presented to us from ACNielsen from time to time.

MR McMAHON: We don’t put a lot of store in it for the same reasons as the information that you’ve got here which is that customer research numbers are open to interpretation for all sorts of reasons. It’s no disrespect to the surveying that’s done. I’m sure they’ve valid in terms of their purpose and objective but not for market share.

MR O'DONOVAN: Okay. Now, the survey was also broken down into, I suppose, sub categories which included packaged groceries and it found that in terms of packaged groceries that the market percentage for Coles and Woolworths was in the order of 79 per cent.

MR McMAHON: Yes, I think we should be clear. I don’t believe that it says that the market share is of that order and magnitude. What it says is that that many customers said they shopped at Coles and Woolworths for the particular period in time. Can I bring you back to a point I made earlier, that this market has more customers who switch between brands than any other market I’ve worked in. So, I’m sure this data is accurate, which is saying that some point in that period, somebody shopped at Coles and they could have shopped at Woolworths.

But they could have also bought their meat from the butcher out the front or their produce from Toscanos or their chicken from Leonards or they may, in one week, come to the Coles and in the next week they may go to the Super IGA because the catalogue offer that they’ve got was particularly strong that week. So, I think it would be unfortunate to draw any conclusions from customer research in respect of market share.

MR O'DONOVAN: Sure. But in terms of assessing particular categories, Coles presumably does keep data down to product categories in terms of market share?

MR McMAHON: We do. It's successively harder to get good, accurate market share information as you start to break it down but we have a view, yes.

MR O'DONOVAN: All right. So, you have a view. All right. And in relation – and presumably packaged groceries or dry groceries is a category for which you do obtain information?

MR McMAHON: Well, we obtain information again from the two sources, ABS, which is in total and the Nielsen information, which is limited. So, we get it for those products and I should also say, as I understand it, it doesn't even include all competitors in the marketplace. So, you can't draw too many conclusions about market share from that information. And, of course, we receive information from all sorts of sources but none of it – all of it helps paints a picture, let me put it that way.

MR O'DONOVAN: All right. And would it be true to say that the picture in packaged groceries is that you have a much higher market share in packaged groceries than in other categories that you - - -

MR McMAHON: Yes, that's true. If we averaged it, between 24 and 25, depending on the month. It bounces around a little bit. Our packaged grocery would be higher and our overall fresh will be lower. We think fresh, for instance, in the range of 19 to 20 per cent and then, you know, on a volume weighted basis, I don't have the exact numbers here but we would be in the mid to late twenties on packaged grocery.

MR O'DONOVAN: All right. And if you were to hazard a guess at market share in packaged groceries for Coles and Woolworths, where would you put that number?

MR McMAHON: I would struggle to, with any authority, to say what Woolworths are for all the same reasons but we would understand them to be in the very low thirties.

MR O'DONOVAN: Okay. So, we're looking at a market share between the two of you in packaged groceries of around about 65 per cent?

MR McMAHON: Not according to my maths.

MR O'DONOVAN: Okay.

MR McMAHON: That would be, you know, 55 – high fifties, is it?

MR TRAINOR: Yes, about 55 to 56.

MR McMAHON: 57, 58?

MR O'DONOVAN: Sorry, didn't I understand you, 29 per cent - - -

MR McMAHON: No, we would say mid – for us, packaged grocery I'm estimating here. The one number we do hold true is 24 to 25 per cent of supermarkets in terms of market share. We estimate that for packaged grocery, broadly speaking, it would be 27, 28. For fresh, it would be 19 to 20. Now, I've done a bit of work on fresh in recent times but I'm estimating the grocery packaged one but if you follow that through on Woolworths' 32, 33 perhaps and add them together, it's certainly not 65 but it would be high fifties.

MR O'DONOVAN: Okay. No, I think my maths was not quite right. Okay. Now, that was all I had on market share.

THE CHAIRMAN: Sorry, just in terms of that market share, you're including in that all outlets for dry groceries, so that would include convenience stores, stores attached to service stations and the like?

MR McMAHON: Yes, I believe that what we're referring to there is ABS measure 3 – 2. Is it 2, sorry - ABS measure 2 which is clearly defined in the ABS but I understand it includes those things. We can check.

THE CHAIRMAN: Right. And in that context then, you include in your own market share not just your supermarket outlets but Coles Express outlets attached to, you know, service stations and the like?

MR McMAHON: Well, if it's in ABS measure 2, that will include the Coles Express sales which I should add, while significant in the C store channel, are quite small compared to - - -

MR TRAINOR: Just to clarify, measure 1, Mr Chairman, includes packaged groceries sold in non-petrol convenience stores and measure 2 excludes them.

MR McMAHON: Okay.

THE CHAIRMAN: Right.

MR McMAHON: Thank you.

COMMISSIONER MARTIN: The only other thing – and I'm sure Mr O'Donovan will get around to prices – but I wondered if you had the same faith in ABS measurements on pricing in the sector?

MR McMAHON: It's not something I'm familiar with and I don't tend to look at because we have pretty good pricing information directly, obviously, from our own stores. So, we use it for market share. I'm not personally familiar with the ABS pricing measures.

MR O'DONOVAN: Okay. All right. Now, then moving on - - -

MR McMAHON: Sorry, Mr Martin, could I just – if you're talking there about inflation, is that what you mean, price inflation? Yes, okay. So, the only general view we have is that the ABS basket, we believe, is not necessarily as representative as it could be of what customers actually buy. So, we think that it could be updated and make sure it is weighted to what customers actually buy and we obviously have very specific information about what customers buy and we can see, at times, you know, quite a difference between what we measure as food inflation and what ABS reports. Sorry, I misunderstood the question, yes.

COMMISSIONER MARTIN: That's the point I was getting at.

MR O'DONOVAN: Okay. All right, then moving on then to the Choice shopper survey, which you have mentioned a couple of times, well, firstly, it's fair to say it was a good result for Coles in that it suggested Coles was cheaper both in terms of its standard shelf pricing and in terms of its specials. Now – well, firstly, would you say that – is that result consistent with what you would expect based on Coles' pricing policies?

MR McMAHON: Yes, we very much believe so, and therefore we're very pleased when it's demonstrated through independent surveys like that. We stay – we monitor prices very closely, and we believe that prices, at a local level, are what matter to customers and, hence, our strategy is geared at ensuring that the store manager has the authority to ensure they're competitive locally on over 331 product lines, and, as we have said earlier, at a state and zone level within a state, we make sure that we're competitive. So we believe that the effect, although it has multiple dimensions, and then you add promotions, house brand and the likes of fair value every day pricing, we believe it's that mix of pricing which gives our customers the best value in this country.

MR O'DONOVAN: Now, Woollies weren't prepared to accept that it necessarily did reflect the true situation across a border that, but if a survey were taken across - - -

MR McMAHON: Were you surprised by that, Mr O'Donovan?

MR O'DONOVAN: No, no, not surprised. But I guess the question for you is, if we were to take a broader sample, and look at all of the items across the store, which I assume that you do at some level, is there – would we find, as Woolworths suggest, that the price difference is much, much, closer between Coles and Woolworths and that, in fact, we'd find the prices were very similar.

MR McMAHON: No, I think if you – first of all it's a competitive market, so, you know, people will respond to prices that competitors put out there, and that includes people responding to us when we lead the markets in the ways that we have described. I had a little bit of work done to have a look at this. We took 10,000 product lines in Victoria, and of those 10,000 product lines – and I'll go off broad numbers here, but around 60 per cent of them, prices were similar. So within a reasonable band, of the remaining 40 per cent they were different between us and Woolworths, was the check that I had done. And of that 40 per cent, 28 per cent Coles were lower, and Woolworths were marginally higher on only 10 to 12 per cent.

So that's the look I had to make sure that we were competitive in terms of what we're looking at. And we have that specific information. We have plenty of information on pricing, obviously because it's something that is our life blood to make sure that we are competitive for our customers.

MR O'DONOVAN: So would the gap of 3 per cent between Coles and Woolworths pricing, on this particular basket, would that be representative of the pricing across the board, or are we talking about a much smaller gap in your own internal information?

MR McMAHON: Well, I think it will vary from time to time. Our aim is to make sure that what our customers buy and, hence weighted towards the basket that they buy, and the high volume lines that we described earlier, is where we're competitive. We're competitive across the range, but very much on those lines. It will vary from time to time depending on what promotions are running at any given point in time, depending on, as we have said, whether competitors have responded to us leading the market to every day fair pricing and the like. So I couldn't say with great certainty that it will always be 3 per cent. I would expect it to be always different, and I would expect that competitors won't like to lose those sorts of surveys, and they'll be doing their best to make sure that they're improving their competitive position to chase us.

MR O'DONOVAN: Right. But – well, I suppose it's been put to us that the pricing of Coles and Woolworths is much more similar than that 3 per cent gap would suggest, that, across the range, you wouldn't find a gap that big between Coles and Woolworths pricing. The question is, in terms of your internal knowledge of how closely you price with Woolworths, would you say that it's less than – there would be less than a 3 per cent difference pricing across the range?

MR McMAHON: It'll vary by category. And, as I say, depending on how strong our promotional programs are. But we - - -

MR O'DONOVAN: Well, just setting aside promotional programs, just dealing only with standard shelf pricing, if you look at standard shelf pricing of products, would you expect to see them much closer than that 3 per cent gap?

MR McMAHON: It could be from week to week. It's probably one where I'm better to have a look at the actual information, but I would expect that we set out to be more competitive on that basket of goods, and we would expect that the results show that. I can't tell you whether it would be 1 per cent, 2 per cent, or 3 per cent. It's probably in that sort of a range. And there may be times when, you know, very strong – I know you're saying exclude promotional activity, but it's hard to because customers buy promotional products. But I'm aware of one media report just in the last week. For instance, in a regional Victorian newspaper that had us at least that much cheaper.

MR TRAINOR: Yes, up in Bendigo, Coles and – the gap between IGA, Coles, Woolworths and ALDI, the cheapest place for customers to shop at Bendigo would be a Coles and ALDI.

MR O'DONOVAN: And so if we were to – again, just going off standard shelf pricing, and broaden it to across the range to, I suppose, to the national – nationally set price – would we expect to see a gap of 3 per cent, or would we expect to see a much smaller gap between the pricing of Coles and Woolworths at standard shelf level without promotion?

MR McMAHON: As I was saying, it's probably closer to somewhere between 100, and it ranges up and down. Terry, do you want to comment?

MR BOWEN: Yes, I think – again, I think Mick's comment to looking at this point in time is always difficult. In my short time with the business it's been certainly up to 3 per cent with our own internal monitoring. If you ask for today's result, or last week's result on our internal monitoring of shelf prices, excluding promotions, which is difficult to do as well because it's such a large part of the value offer, currently it would be less than 3 per cent.

MR O'DONOVAN: All right. So you do monitor it over time?

MR BOWEN: We do.

MR O'DONOVAN: And do you find that it tends to be – there tends to be a gap or does it – or is it true to say that the Woollies and Coles pricing very much is drawn together?

MR BOWEN: With a relatively short experience, it would be fair to say that the, if you like, the science that's being put into our price gathering has improved a lot in the last kind of six to 12 months. Much more focus on making sure that we are really competitive given the issues in the business of 12 months ago, and making sure that we really do, you know, have a very strong value offer to customers. And over that period of time, you can tend to find that the – it's generally been in Coles' favour on all the data that I have seen.

MR O'DONOVAN: And could you give us an order of magnitude in terms of that – just an average over time, say, in the last 12 months?

MR BOWEN: Again, it fluctuates a little bit. It'd be within the 1 to 3 range, but probably - - -

MR McMAHON: I think it's worth saying the reason we're struggling a little bit is because we – normal sells is only part of the competitive gain. So we set out to be more than competitive on them, and come back to the promotional programs, the likes of every day best value, the likes of house brands. So when we're looking at it, we're looking at the whole mix. So, hence, normal sell price is just one dimension.

MR O'DONOVAN: Okay. And do you have technology that can take account of promotional sell pricing?

MR McMAHON: We can capture prices in a way that allows us to look at the effect of promotions, yes.

MR O'DONOVAN: Okay. For your competitors as well as for you?

MR McMAHON: Certainly for ourselves, obviously, we have technology. For competitors we monitor shelf prices to make sure that we're competitive.

MR O'DONOVAN: Sure. Okay. So – and, again, in terms of the report that you receive, that take account of promotions and all of those other things, do we see this same – do you see, in those reports that you get, this same gap of between 1 to 3 per cent, or do you see the prices pulling together much closer than that?

MR McMAHON: Well, with promotions they can – because they – as I have described earlier, customers in this market switch between brands. Not only the large ones that we're talking about here, but the smaller ones. So promotional battle ground is a fierce one, if you like, and that one can bounce around a little bit more from week to week but, again, we aim to make sure that we have the best specials out there for our customers.

MR O'DONOVAN: Okay. Now, if, for example, some of the large format IGAs, like the Foodlands in South Australia were included in the survey, based on what you said this morning that would seem to suggest that they might come out in front ahead of Coles, in terms of the price offering on a basket of goods. Would you agree with that proposition?

MR McMAHON: No, to be – they could from time to time. So I'll just give you a typical answer. So, first of all, we do include the Super IGAs in our price checking. And, typically, across the whole range - so let's call it the top 1500 lines – we will be more price competitive than the Super IGAs. However, on any particular promotional line, you know, they may have two, or three, or four, or five promotional lines in any week which are very strong and cause customers to switch between brands.

MR O'DONOVAN: So would there ever be a time where an independent Foodland could be 3 per cent – as much as 3 per cent cheaper on this sort of basket of goods than Coles?

MR McMAHON: Well, not – they might start out there, but our pricing system and the license we give our local store managers to be competitive would pretty quickly close that gap.

MR O'DONOVAN: All right. Now, in the same survey, in the – sorry, in Coles – sorry, Choice conducted the survey in 2003, and then conducted another in 2007. And the inflation that it noted was prices were up 12 per cent for Coles. And in the same period ALDI was able to decrease it's grocery prices by .7 per cent. Is there a reason why ALDI was able to hold its prices steady and, in fact, decrease them to consumers whereas Coles increased it?

MR McMAHON: I think two things. I'm not familiar with the detail of that, but Cameron may be. So let me just respond generally first, and see if Cameron wants to add to that. But, as I described earlier, you know, ALDI has a particular business model which includes virtually 100 per cent house brand. To make a like for like comparison, we would want to compare our house brand, inflation through that period to their inflation through that period, and we'd possibly find, but I don't know, that that would make them much more similar than others. Cameron, do you want to comment?

MR TRAINOR: Yes, just to pick up on Mick's point there, a lot of the products in that Choice survey are products that ALDI don't sell. So these are branded FMCG manufacturers proprietary brands.

MR O'DONOVAN: Sure. But in terms of its ability to hold products in that category at a constant price, it's obviously been better able to do that than Coles.

MR TRAINOR: Not necessarily. There would be elements of inflation that Coles has had to contend with, but there's also examples where Coles have held prices on behalf of our customers .

MR O'DONOVAN: Sure. Okay. So if we were to do a study of the inflation that Coles – I suppose the price increases that Coles passed on through that period, focusing only on house brands, we might find a different result. Is that

MR McMAHON: Yes, I don't have the number in my head, but as we described earlier, particularly house brand and those entry level are good quality products, they're the ones that we make sure we are competitive with ALDI on. So I would imagine that they would track a similar trajectory to ALDI, but I haven't looked at that data.

MR O'DONOVAN: Okay. But that is data that you keep, and a study you could do?

MR McMAHON: Possibly. The only point is there's been so much change in Coles, and we have introduced so many new Smart Buy and You'll Love Coles products over that period of time. But I'd have to have a look to see how viable the comparison is.

MR O'DONOVAN: Right, okay. All right. So you don't think it reflects a greater willingness on the part of ALDI to share cost savings through the supply chain with its customers?

MR McMAHON: No, I think that's a question you'd have to ask them, but we don't believe so, no.

MR O'DONOVAN: All right. So Coles, in terms of the savings that it makes through better buying with its suppliers and in terms of the cost savings that it makes through the supply chain, would it be fair to say that they will readily pass through to Coles shareholders or more readily pass through to Coles customers?

MR McMAHON: We're on the public record, and certainly I've been saying it for over 12 months now, that Coles, at that point in time, needed to be much more competitive, particularly in the wake of some of the challenges that Terry referred to earlier. We have invested over $100 million in lower prices over the last 12 months that our customers benefit from. A lot of it in fresh, a lot of it in products like milk, a lot of it in areas of house brand. So we think that our customers are benefiting from our investment in lower prices. That obviously helps us in terms of higher volumes, you know, faster stock turn, lower shrink, lower wastage, more efficient stores. So it's a win/win if we can get that right.

Over time, one of the challenges for us, under Wesfarmers ownership, is to get the balance right between what we invest for our customers, and there needs to be a significant amount of continued investment either in continuing to invest in better prices or in modernising and refurbishing the stores, and what we return to shareholders. But what we return to shareholders, ultimately, will only improve if we improve the offer to our customers.

MR O'DONOVAN: That's all I had on pricing.

THE CHAIRMAN: I just want to pursue this a bit further, because I'm just trying to reconcile the sort of evidence we're getting from various sources. And it's all been on the public record, but you're suggesting that the – that Coles would generally be across a basket, whatever that might mean, of goods between 1 and 3 per cent lower in prices than its competitor Woolworths.

MR McMAHON: No, what I'm very careful to say is it will bounce around.

THE CHAIRMAN: Yes.

MR McMAHON: And we can talk through some specific information later on if you like. It will bounce around, but we have deliberately set out, particularly over the last 12 months, to make sure that that's the sort of space that we're in.

THE CHAIRMAN: Okay. And thank you for correcting that, but that gives me enough sort of specifics to go on with. Woolworths, on the other hand, gave evidence last week that says that, on known value items, as they call them, that their store managers are under a management direction to lower prices to match.

MR McMAHON: Yes.

THE CHAIRMAN: Now, what I'm trying to figure out is this. Is if Woolworths matches, and you're 1 to 3 per cent lower, bouncing around of course, as the way you have described it, when is the gap occurring and when is it – I mean, if Woolworths is catching up quickly, as, you know, might be implied, how do we get this 1 to 3 per cent gap?

MR McMAHON: Because, as I tried to describe earlier, we're talking about different dimensions of our pricing approach. So normal sell – what we call normal sell price and what the store manager can do on a local level is to make sure that, across the full range at any point in time, we're competitive. But, in particular on, as I said earlier, 331 – use that term – known value items or key value items, we need to add back. That's why I keep pushing back a little bit to say it's a bit hard to exclude promotions, it's a bit hard to exclude house brand, it's a bit hard to exclude best value every day and move from high or low pricing to more consistent pricing for customers.

And if we stood still we'd be caught, not only within months but certainly within weeks and possibly days. So it's about each week as we go about agreeing or setting our promotional program, choosing which products we're going to move on to best value every day. So at the moment I think lamb leg roasts are the next ones to go to best value every day pricing.

THE CHAIRMAN: And that I think is the answer that I expected, which is that the choice of – choice is perhaps a bad word in the context of their survey – but the choice of baskets, and the choice of those items in respect to which comparisons have been made, I mean, can be highly speculative, can be highly ad hoc. If, for example, the ACCC were to send out a group of buyers to make a selection and just – they took a basket that they just picked ad hoc, would we necessarily find that there would be a 1 to 3 per cent saving by going to Coles, or could it operate the other way around, or is it all going to depend on which basket - - -

MR McMAHON: No, I understand.

THE CHAIRMAN: I'm trying to just identify very carefully which of those areas that are bouncing around between that 1 to 3 per cent reduction or discounted margin.

MR McMAHON: So first of all, if you take from a pure statistical perspective, which I think is what's behind your question, from the response I gave earlier about how varied our pricing is in response to Woolworths, you could get any outcome if you took a random selection of products. Absolutely no problem with that. But I'd come back, as retailers we're interested in what our customers see. We're trying to measure those things which are typically in the basket, which are high value items, which are critical lines for, you know, for a household out there struggling with higher prices at the moment. They're the ones we focus on, and we'd say huge encouragement from the likes of Choice surveys or the smaller example in Bendigo that was mentioned earlier. It's all the information we take into account. But I can assure you that it's a daily and weekly challenge to make sure that we stay competitive.

THE CHAIRMAN: And where do you think your greatest pressure is coming from at the moment, ALDI or Woolworths?

MR McMAHON: We find that on price that they're all significant challenges, particularly around obviously house brand, ALDI is a formidable competitor. I mentioned Super IGA, and the likes of Franklins in New South Wales. And clearly Woolworths is a very strong competitor. So I guess we don't differentiate too much. They're all a challenge for us.

THE CHAIRMAN: In terms of house brands, is your major – the major competitor driving force ALDI or Woolworths, or Black Gold IGA?

MR McMAHON: Well, both – sorry. It's primarily ALDI and Woolworths because Woolworths tend to respond to the competitive challenge in the same way by – they have, as I understand it, introduced, you know, more house brand products. We believe that our house brand brands are stronger from our research, but I'm sure if you talk to Woolworths they'd say the reverse.

COMMISSIONER KING: If I could just follow up on a couple of points, Mr McMahon. You mentioned the survey of 10,000 items I think in Melbourne, was it?

THE CHAIRMAN: We did a one-off check from our price data, yes.

COMMISSIONER KING: And I think from memory you said approximately 40 per cent was it were about the same as between yourselves and Woolworths?

MR McMAHON: The other way around, around 60 per cent were broadly similar.

COMMISSIONER KING: 60 per cent were - - -

MR McMAHON: That's not to say they're the same but in a space.

COMMISSIONER KING: Okay. So what do you mean by broadly similar? Do you mean within 1 per cent, 5 per cent, 10 per cent, not double?

MR McMAHON: Well, I can check exactly for you if you like. As I said, I just had a quick look at it last week.

COMMISSIONER KING: Okay. That would be useful so that we can get a handle on that. Now, I want to check that I heard you correctly. I think you said that of the remainder Coles was cheaper on about 28 per cent, was that - - -

MR McMAHON: Yes.

COMMISSIONER KING: So when you're saying 28 per cent, are you saying 28 per cent of the 40 per cent, so in other words on 72 per cent - - -

MR McMAHON: No.

COMMISSIONER KING: - - - Woolworths was cheaper or - - -

MR McMAHON: No, no. No, absolutely not. I hasten to add, I probably wouldn't have used the example. No, so 60 broadly similar. The next, 28 - - -

COMMISSIONER KING: Yes.

MR McMAHON: - - - our prices were lower, and around 12 I think is the balance.

COMMISSIONER KING: Okay. Well, if you could give us a bit more of a handle on what broadly similar means, just for a - - -

MR McMAHON: Sure. We will. As I say, I had a look but it's back to the Chairman's point obviously; at any point in time you can take different samples.

COMMISSIONER KING: Yes.

MR McMAHON: But it's just one of the things we had a look at.

COMMISSIONER KING: The other thing, you stated that you had invested a hundred million in the last 12 months in lower prices. What does investing in lower prices mean?

MR McMAHON: Okay. If I use an example, because I think this is also important to get the point around the unit price versus net benefit, if you like. So we ran a campaign called La Fresh to increase the participation rates of our customers in fresh, the buying produce and meat and so on in our stores. Our plan was to invest just under $50 million in that, $49 million in lower unit prices. Our plan was also to generate more volume as a result of doing that. And, therefore, the net cost of that $50-odd million investment would have been closer to 25, 30 million dollars.

So by investing in prices, we're talking about the unit price investment to lower prices for customers. If we're successful in doing that, as we were, then we will generate more sales of chicken breast, more sales of bacon, more sales of barbecue chicken and the like, and we will increase our turnover, our stock turn. We will reduce wastage, and it leaves to a more efficient supply chain.

So we're not doing it just to give away money, shall we say. We're doing it because if we can attract more customers, it makes for a healthier retail business. And that's why part of this debate is about unit prices. But at the end of the day we're investing in – sorry, we are trying to generate sales and gross margin dollars.

COMMISSIONER KING: It still strikes me as being a very odd way of describing it though. I mean, I could immediately have you investing a lot more in lower prices in the next 12 months so I would just suggest to you if you put up all your unit prices, or put up your unit prices on half your items by 10 per cent and then just drop the price again on the unit price, and you can call it – you've invested millions more. I mean, it doesn't seem to be – when you're saying you've invested in lower prices, all you're really saying is that for whatever reason you've had to drop the price on some products. And presumably you're doing that because it's profit maximising for Coles. You're not giving money back to the consumer; you're making more money for the Coles group.

MR McMAHON: Well, first of all, we didn't put up prices just so we can drop them. It would be a quick way to go out of business in retail. And I'm not sure you can dismiss quite as easily lowering prices for whatever reason. That's what we do; that's what we did. We believe that we needed to offer – again back 12, 15 months ago we needed to offer better value to customers. And we invested in that example; $50 million in lower unit prices. If it hadn't worked for customers, if I got no extra sales as a result, it would have cost me $50 million, I can assure you, straight off the bottom line. But because it worked in increasing sales, in lowering waste and the like in fresh, we offset around half the cost of that.

Now, obviously any investment decision that you're making you want to make eventually more than what you started with. So I'm talking about, you know, through that period of time. But over time if we're not competitive, we won't generate any returns for our shareholders. Another example is, for instance, in our house brand milk. We have experienced significant cost – or increases in cost of goods coming through in our house brand milk and we've only passed around a third of that on to customers. On an annualised basis that's around $20 million.

But the customers are benefiting over and above what the prices would have been if we'd passed through all of those cost of goods increases. So I can assure you in a retail sense these are very real, and they are tough decisions that we have to make in order to ensure that we are putting the right prices in front of our customers.

COMMISSIONER KING: Just finally though, whilst the customers are benefiting, presumably it is also benefiting Coles and it is benefiting your shareholders. So it's not that Coles is doing this out of the goodness of its heart to its customers, it's doing it as a competitive strategy to make more profit presumably.

MR McMAHON: And we don't apologise for that at all. We can only though make more profit – and I think the history of Coles in the last several years would probably illustrate that – ultimately you will only survive and thrive if we get the offer right for our customers, and that includes making sure we're competitive, as we believe we have significantly moved to do over the last year or so.

THE CHAIRMAN: Just one final one. 1 to 3 per cent, it sounds impressive and it's – you know, goes well in Choice survey, but it's 1 cent in the dollar, and it's $1 in $100 dollars. Is that of – on your market analysis, of such significance as to attract more customers to you? Or are there other factors that are either attracting customers to you or taking it away from you?

MR McMAHON: That's a good question. That's why we said earlier that while this is an inquiry into grass root pricing, there are many other things of customer choice in this market. And we're also very conscious that, you know, at a time when household budgets are under pressure for all sorts of reasons, 1 to 3 per cent doesn't sound much, we understand that. But we do within that make sure we are doing our best to offer things like bread, milk, eggs, you know, the real staples as cheaply as we can.

But to answer the question more specifically, customers still make choices based on location primarily. They'll make choices based on range; so can they shop and get all the things that they need in that location. They will make decisions based on service, and I include not just the checkout service but things like ensuring that the product is available on the shelf. And, you know, going back in time, Coles had its problems in that respect as well which are now well on the way to being sorted out. So there's a whole raft of things that you need to get right, and it's not enough just to have a sharp price on the board. That's why I made the point earlier that imposing a retail offer on customers in some way just because it's got a low price won't necessarily help anybody if customers don't like the location or the product or the range or the service that they receive.

THE CHAIRMAN: I can almost predict the answer to this one, but you've stated as publicly is - your objective is to increase the EBIT margins.

MR McMAHON: Yes.

THE CHAIRMAN: Increase the gross margins as well. By increasing prices?

MR McMAHON: No. I don't think we've said publicly to increase gross margins at all. In fact, one way to increase EBIT margins – and that's why I made the point about the difference between unit prices versus generated gross margin dollars, because gross margin dollars are a product of unit price and selling more volume. So our drive to improve our EBIT margins will include offering better value to customers, generating more sales and more volume, lowering our cost right through the chain – both on a unit cost basis as well as through structural improvement, a lot of which we've already done – to simplify and take a lot of overhead cost out of Coles. And there's still a lot of work to do, as I think is on the public record, to get our supply chain into the sort of shape it needs to be in to compete in this market.

MR O’DONOVAN: One final question on pricing. It does seem surprising that a sophisticated competitor like Woolworth would let itself be beating on price by what in supermarket terms is a huge amount, 3 per cent. How can you explain they’d let you get that far ahead?

MR McMAHON: I don’t try to explain it, I just – we’re very pleased with the outcome of the Choice survey. We have other data points, if you like, which we think reflects a similar position. But we’re in no way complacent and next week it could all be different. In other words, there could be a strong response.

MR O’DONOVAN: Okay, but do you have other data points that suggest that this is overstating it?

MR McMAHON: No. I referred earlier to just an example recently through the media; I am talking about independent price surveys here.

MR O’DONOVAN: Yes. No, no, I am just talking about in terms of your internal data. On your internal data is - - -

MR McMAHON: No, our internal data, subject to the Chairman’s point, that obviously we’re tracking the products that we think our important to our customers. Our competitors will be tracking those, you know, and there’s - obviously there’s going to be a high degree of cross over, but there could be some differences. But we have explained what we track and what we watch, but I wouldn’t want to give the impression that we’re in any way complacent about that.

MR O'DONOVAN: But you’re satisfied that the difference is there? That over time - - -

MR McMAHON: I can only refer to the – you know, to the independent surveys that were mentioned there on the public record, and, you know, it’s for others to respond how they let that occur.

MR O'DONOVAN: Sure, but if were to look at – if we look at the data, perhaps confidentially the data that you look at internally, would we see the same thing?

MR McMAHON: I think we have said that it’ll be in that range. It’ll bounce around week to week because of the mix of normal sell promotional prices and all the rest that I have described, house brand and the like. But we take great comfort from the independent surveys on the public record that show us to be not just competitive but the lowest price player in the country.

MR O'DONOVAN: I’m not sure that that quite answered my question. If we were to look at only at your internal – just ignoring the independent surveys – if you were to look only at the independent data, would we see confirmation of those results, or would we see a slightly different picture emerge?

MR McMAHON: Yes, you will see results consistent with the answers that that Terry and I have given.

MR O'DONOVAN: And consistent with the independent surveys?

MR McMAHON: Yes, I believe we have said that, in that range.

MR O'DONOVAN: All right. Okay. Now, moving on to, what I think in the business is described as, category management.

MR McMAHON: Yes.

MR O'DONOVAN: Now, our understanding is that they way in which, I suppose, areas of a supermarket are now managed, it's the – from a supermarket's point of view you manage the whole category. You don't just focus on a single product and its margin, but you look at the category broadly and try and maximise the margin you can make across the category. Is that fair to say?

MR McMAHON: Not entirely, no, because it's not just about margin, it' s about sales and it's about choice for customers. So we manage a number of – so our definition of category management is managing, you know, a wide number of factors that starts with obviously what customers want in ensuring that we provide the choice that they want in any particular store, the mix that will generate the right sales, the mix that will generate the best margin, but also the lowest wastage, the lowest store handling costs and the like. So I just broaden that out beyond margin.

MR O'DONOVAN: But, in terms of the category itself, you look at it as a category, not just as a series of single products.

MR McMAHON: Yes, we'll look at it on both dimensions but, absolutely, that's right for category management, yes.

MR O'DONOVAN: Okay. And so there is some analysis – certainly some analysis done at the category level.

MR McMAHON: Yes.

MR O'DONOVAN: With a view to - - -

MR McMAHON: Definitely.

MR O'DONOVAN: - - - seeing whether it's set up in the best way in – in a way that delivers best performance for the business.

MR McMAHON: Yes, that's right.

MR O'DONOVAN: Okay. All right. Now – and the – as, I suppose, part of the category management strategy, the house – the introduction of house brands plays a role in managing the category, would that be fair to say?

MR McMAHON: It does, yes.

MR O'DONOVAN: Okay. And that each of the house brands plays a different role within the category in terms of - - -

MR McMAHON: The different brands do, yes, that's right.

MR O'DONOVAN: Yes. So the Coles Smart Buys tries to be the cheapest in the category, is that the goal for Smart Buy?

MR McMAHON: Well, it's an entry level product, so it will be certainly on a – at least on a price equivalent basis with a similar quality product in the competitor, yes.

MR O'DONOVAN: Okay. But not necessarily the cheapest product in the category?

MR TRAINOR: I'm just sitting here thinking - - -

MR McMAHON: You're trying to think of something.

MR TRAINOR: - - - of any, and I can't recall any where that would be the case. So they generally would be the cheapest entry level product in the category.

MR O'DONOVAN: Okay. All right. And then in terms of You'll Love Coles, that's similar to a branded product but not necessarily the leading branded product, is that - - -

MR McMAHON: No, in fact our – in terms of quality it's at least as good as the leading national brands, but we price it at least 10 per cent lower, is our brand objective and that could be in the – well, across You'll Love Coles and Smart Buy that can give you price points in the 10 to 20 per cent lower than leading national brands.

MR O'DONOVAN: Okay. And in terms of quality are you aiming to equal the category leading brand, or just a brand, a prominent brand within the category?

MR McMAHON: It doesn't necessarily have to be the leading brand, but obviously that's the mark if we can get there. Cameron, do you want to add to - - -

MR TRAINOR: We would benchmark our You'll Love Coles products that would need to be equal to a group of leading brands in the category, if not better.

MR O'DONOVAN: Right. Okay. But it's not the same as Woolworths Select where they say they pick, in terms of quality, the brand leader in that category and match it for quality? That's a slightly different approach?

MR TRAINOR: We would benchmark a number of leading brands in quality –for quality – across the category. Typically that would include the market leader, but other brands also in the category.

MR O'DONOVAN: Okay. All right. And then in terms of price ambition, it's to be 10 per cent lower?

MR TRAINOR: As a minimum we would aim it to be 10 per cent below leading brands in the market place.

MR O'DONOVAN: Okay. And then Coles finest, it doesn't – where does it fit within the category?

MR McMAHON: Well, we have – our main focus has been on Smart Buy and You'll Love Coles in order to deliver the sort of value, that we have been talking about this morning, to our customers. We have a limited range of Coles finest at this stage. 30 to 40 - - -

MR TRAINOR: 34 products of Coles finest.

MR McMAHON: 34 products.

MR TRAINOR: It's a small emerging range for us. An important range. And it primarily comes into its domain for customers around the peak seasonal periods like Christmas. It is a brand that we're planning to invest into in the future, but it's a small range for us at the moment.

MR O'DONOVAN: Okay. Now, then in – and in terms of the things that it delivers to Coles – so just looking at it from Coles perspective, it enables you to put a product on the shelf that provides Coles with a bigger margin that it would earn on the equivalent product within that category? Is that true to say?

MR McMAHON: Well, even from a Coles perspective, our first objective is to give customers choice, and make sure that we have the products that they want so they don't have to go elsewhere to get them. And that's a very powerful factor. The second one is that, on those products, we would tend to generate a higher per cent margin but off a lower dollar price, if that makes sense.

MR O'DONOVAN: Yes.

MR McMAHON: So typically 5 to 6 per cent.

MR BOWEN: Yes, additional gross margin percentage.

MR McMAHON: Percentage off a lower dollar price.

MR O'DONOVAN: Okay. So from a customer's point of view they get a cheaper product, but from Coles point of view, in terms of the percentage it can make – or it does make – on the product, it's higher than it would on the branded product.

MR McMAHON: Yes, and tend to make more money on it. The only thing I would say is that, obviously on house brand products, we are wearing the cost of development of the product, the quality control of the product, the marketing of the product, the packaging of the product, and increasingly the sourcing of the product involves it coming into our supply chain, and us – there are no trading terms on house brand products. In other words, there is no working capital benefit for it, just the reverse.

MR O'DONOVAN: Okay. So, does that mean – are you suggesting by that that you pay for it in advance, cash on delivery?

MR McMAHON: More so particularly where there's a long supply chain importer product or the like.

MR O'DONOVAN: Right. But there are certainly domestic house brand products which you don't pay for till well after they've arrived, that would be true?

MR McMAHON: No, I'm not aware of - - -

MR BOWEN: I'm not specifically aware of the domestic ones but - - -

MR McMAHON: Cameron, do you know?

MR TRAINOR: No, we would normally pay for the domestic house brand as it's received into your distribution centre in line with the normal payment cycle with agreement to supply.

MR O'DONOVAN: All right. And so that would be true for milk, eggs and bread and all of those?

MR TRAINOR: Correct.

MR O'DONOVAN: Okay. All right. Now, again looking at it just from Coles' perspective, house brands deliver an additional advantage to Coles in that it improves their negotiating position with the makers of branders products, would you agree with that proposition?

MR McMAHON: Yes, we believe – we think house brands are pro competitive because they create competition for shelf space, certainly, and they introduce competition into categories and ranges where perhaps not too much existed before.

MR O'DONOVAN: Okay. So, what they might give you is leverage over a supplier in terms of your commercial negotiation with them that they need to deliver to you a better margin if they're to stay on your shelves?

MR McMAHON: Well, the first thing we would say is that they offer leverage to make sure that we can give customers a better price. So, to give you a chocolate example, block chocolate, you know, our supplier of block chocolate prior to introducing You'll Love Coles Belgian chocolate had something like a 70 per cent - - -

MR TRAINOR: Yes, 70 per cent.

MR McMAHON: - - - share of our sales.

MR TRAINOR: The market leader had about 70 per cent market share in the block chocolate category.

MR McMAHON: And we introduced You'll Love Coles Belgian chocolate which has been phenomenally successful and we've probably got 15 per cent of our sales, something like that and growing, and that has caused quite a change of heart from that leading supplier, both in terms of more promotional support to lower the price of their products. And, in fact, just recently to lower the regular price point for a six month period.

MR O'DONOVAN: Okay. And is all of the value of that delivered to the customers or is there also some benefit to Coles shareholders in terms of improved EBIT margin from those?

MR McMAHON: If we get a house brand right, we expect to meet both objectives.

MR O'DONOVAN: Right. Okay. So, it's fair to say, is it not, that this – the category management and the introduction of generics has very substantial commercial upsides for a company like Coles?

MR McMAHON: Potentially, yes. Yes, I think that's fair.

MR O'DONOVAN: Okay. And it's equally true to say that the introduction of these products was not really at the insistence of customers. It wasn't a drive from customers to have generic products, it was really something that was imposed on the market by Woolworths and Coles?

MR McMAHON: Well, I – sorry, Mr O'Donovan, I don't agree it's been opposed in any way and actually you're talking about generics.

MR O'DONOVAN: Sorry, I should have used house brands perhaps. House brands is what I was getting at.

MR McMAHON: Okay. Yes, because generics is something that, you know, - yes, okay, well moving onto house brands. House brands have been in Coles for a long time since the 60s - - -

MR TRAINOR: Yes, 1960. ’62 we introduced the first house brands in our supermarkets.

MR McMAHON: And we’re putting more focus on them. As I understand it – it predates me, but as I understand it, it in large part is a result of ALDI entering the market, who, as I’ve said before, are virtually 100 per cent house brand. So I actually think customers are demanding it because they’re saying I’m going to go to Woolworths to buy that pasta – sorry, I’m going to go to ALDI to buy that pasta or that milk or those eggs, unless you have a product of similar quality and better value.

MR O'DONOVAN: All right. Well, just dealing with the first point about how long house brands has been around. It’s true they’ve been around a long time, but in terms of their prominence and as a commercial strategy for major supermarkets, it’s dramatically increased in the last five years, it would be true to say?

MR McMAHON: I think the focus has increased. Actually when you look I’m not sure the product numbers have necessarily increased because a lot of products which people were used to, the likes of Farmland, Persona, the red box in BI-LO, I’m not even sure people necessarily knew were house brands, they just knew them as a brand that they trusted.

MR O'DONOVAN: But you would accept that the focus has?

MR McMAHON: Absolutely.

MR O'DONOVAN: Yes. And in terms of as a driver of the business they’ve become much more prominent?

MR McMAHON: Yes, because we think they’re pro choice for customers and pro competitive and, you know, as we’ve reported recently in our sales results, you know, our sales are growing double digit on house brand particularly at the Smart Buy and You’ll Love Coles end of the world as customers look for better value.

MR O'DONOVAN: But it’s true to say that there have been reports that customers are unhappy with losing branded products and being effectively forced to switch to a You’ll Love Coles category. You would agree with that?

MR McMAHON: It’s certainly something that our research says which is that our customers want to have the choice and it’s our intent to give them the choice, to make sure that they have a choice of leading national brands and our house brands. If we got that wrong and customers felt forced that would not be a good outcome, either for the customer or for the business.

MR O'DONOVAN: Okay. But it will – let’s deal with it in stages. Firstly, you have had those reports that customers aren’t – would prefer a bigger range of brands and less focus on generics; would you agree with that?

MR TRAINOR: No. Just on that, we’ve recently read some research that says the Australian population has got a 79 per cent propensity to buy into house brands in this country, which says to me at least that over time consumers are accepting the brands more and more – the house brands more and more. From a category management perspective we’ve got the job to be done to ensure that we arrange the most relevant range of branded products and house brands for our customers, because customers are faced with a choice here; they will walk if we don’t range accordingly to what they need.

MR O'DONOVAN: Sure. Let’s deal with propensity first though. All that shows is that if they’re put there they will – without an alternative they may ultimately adopt them. Would you agree with that?

MR TRAINOR: If there was no viable alternative and I think the other thing to understand would be that Australia by European or western world standards has a very low percentage of house brands as a per cent of total business.

MR O'DONOVAN: Now, just in terms of what customers are feeding back to you.

MR McMAHON: Sure.

MR O'DONOVAN: I mean, it was reported in the paper on the weekend that store managers were telling your CEO customers wanted brands and didn’t like the You’ll Love Coles format. Are you familiar with those newspaper reports?

MR McMAHON: One thing I’ve learnt in Coles is that not to believe everything that we see in the newspaper, but I’m sure if that was reported that was what the reporter heard. But I mean that’s one – if it was said, and I don’t know, I wasn’t there, but that is one comment.

MR O'DONOVAN: Sure.

MR McMAHON: I can assure you that customers vote with their feet, and as we reported to the market last time, house brand sales are growing at 11 per cent: as Cameron has said, a very high acceptance among Australian customers. And more than that, they’ll tell us that they’ll go to ALDI or elsewhere if we don’t have those good value products for them.

MR O'DONOVAN: All right. So are you saying that you haven’t – in terms of the store manager reports back to you that - the reports are inconsistent with that newspaper report, that store managers aren’t telling you internally that customers would rather have brands than You’ll Love Coles?

MR McMAHON: No, not any generic statement like that. Of course, as Cameron described, if we get it wrong and we withdraw the wrong product, then – by the way, that may occur in the normal course of business, being totally unrelated to house brand, you can get your range and choice wrong. You can pretty quickly find out about that in retail and you can fairly quickly respond and get the product back on the shelf for the customer. So we get lots of range feedback from our store managers and we get lots of range feedback from customers. Is it all about house brand, no.

MR O'DONOVAN: Okay. So you wouldn't accept the proposition that this – the drive to house brands from Coles and Woolworths, and more restricted ranging within supermarkets, you wouldn't say that – you wouldn't agree with the proposition that that's reflective of the lack of competition and customer responsiveness on the part of Coles and Woolworths?

MR McMAHON: Absolutely not.

MR O'DONOVAN: So would you – now, in terms of category management the You'll Love Coles, I suppose, expressly prices off other products within the category, so it aims to be 10 per cent below the other branded product. That is - - -

MR McMAHON: At least 10 per cent, yes.

MR O'DONOVAN: At least 10 per cent below, all right. Now, ordinarily when – and you've effectively introduced a competitor into that category. That is the case, isn't it?

MR McMAHON: We've introduced a competing product, yes.

MR O'DONOVAN: Yes, a competing product into that category. And ordinarily in a competitive environment one of the competitive responses you would expect is that the branded product would attempt to lower its price to meet the competition? That is standard competitive behaviour; you would agree with that?

MR McMAHON: Typically, yes, I've given an example of that. It depends on what the owner of that brand intends for their product. Some might see their brand as a premium brand and it's more about the brand positioning and the quality of the product, may be less interested in lowering the price. Others are very interested in lowering the price.

MR O'DONOVAN: Okay. And that puts Coles in the unusual position of controlling both the pricing of its own product, in respect of which they have made certain, I suppose, representations to the customer about where its price will fit and the retail pricing of the competitor product?

MR McMAHON: Well, it's certainly true that we set retail prices in our stores, absolutely. I'm not sure that that's unusual. I think, as we've said here, house brands have been around since the sixties to my knowledge, and as Cameron has said, we have very low penetration of house brands compared to other markets in the world, so I'd only disagree with the unusual piece.

MR O'DONOVAN: Sure. So then if a competitor were then to come to Coles – a supplier were to come to Coles and say that either they want to reduce the wholesale price or increase their rebates or case deals or pay more for promotion, with the result that it would lower their branded product to below the price of the You'll Love Coles product, there are substantial disincentives on Coles to pass on – to, I suppose, agree to that increased level of promotion, increased level of rebate; would you agree with that proposition?

MR McMAHON: I don't know if Cameron has got any examples, but we would want to maintain our relative price positioning and I just differentiate, I guess, between promotions for a period of time versus permanently lowering of prices.

MR TRAINOR: Well, if we take Cadbury's block chocolate as an example, we've lowered the regular sell price of Cadbury block chocolate from 4.69, from memory I think, to $3.99. That was for a period of 22 weeks. I think it started last week or the week before. We've negotiated at the request of some branded manufacturers where we will allow promotions into our business to support their brands. One that springs to mind is Continental Pasta and Sauces normally promotes at around 99 cents to $1.19, and I think from memory the You'll Love Coles price, our standard sell would be $1.49 to $1.59. Greenseas Tuna, the tuna tempters, the 95 grams, from time to time that will be promoted anywhere between 99 cents and $1.19. In fact I think this week catalogue said $1.19 and the You'll Love Coles price is at, I think from memory, $1.19 or $1.25. So we do negotiate with suppliers to support their brand and strategies, as well as our house brand strategy. So we wouldn't restrict it, no.

MR O'DONOVAN: Okay. So it hasn't had the – so at least in terms of promotion you're saying it's not had that effect?

MR McMAHON: No, we think just the reverse. It's pro competitive and pro customer because it's introducing that sort of competitive. There's no doubt some competitive tension in there, we don't apologise for that. We're dealing with some of the largest FMCG companies in the world so we don't apologise for extracting a better price for our customers.

MR O'DONOVAN: Are you aware of any time where you've refused an offer of promotional pricing on the basis that it's not consistent with what you want to do with the category or your category management goals?

MR TRAINOR: Nothing in my time, nothing that springs to my mind immediately, no.

MR McMAHON: And we should just be clear, we don't accept every promotion proposition that's put to us. I don't believe we've made any different decisions because of house brand.

MR O'DONOVAN: Okay. Now, putting aside promotions then and looking at more permanent reductions like a permanent change to the rebates that you get or a permanent reduction in the wholesale pricing, have you ever refused to accept a rebate that was offered on condition that you lower the retail price?

MR TRAINOR: Sorry, can you just explain what you mean by rebate?

MR O'DONOVAN: Well, as I understand it, on some products you get a percentage off the standard wholesale price or you negotiate a - what I think it is called a case deal - - -

MR TRAINOR: A case deal, yes.

MR O'DONOVAN: - - - where you're actually paid money to - - -

MR TRAINOR: Yes, we pass on our case deals through to our customers in the form of what normally would be lower promotional price points.

MR O'DONOVAN: Yes. But going back to the rebates in terms of the other percentage agreements that come off the wholesale price, have you ever refused - - -

MR TRAINOR: An increased rebate?

MR O'DONOVAN: - - - an increased rebate where it was offered only in exchange for a permanent lowering of the standard shelf price of a product within a category?

MR TRAINOR: Well, traditionally rebates wouldn't normally come into – if rebates, as I think we both understand them to be, wouldn't really come into a discussion around a retail sell price per se on an individual item at a point in time. It would be more around from a promotional perspective what is the case deal that we want to pass onto our customers.

MR McMAHON: Not too many buyers knock back increased rebates. So I'll just come back to my earlier answer which says, we don't necessarily accept every proposal that's put to us, and I'm not aware that we have markedly changed or changed our practice in respect of – because of house brands.

MR O'DONOVAN: Okay. So as far as you're aware, there's been nothing within your organisation in terms of how you deal with suppliers, and your willingness to pass on benefits that they offer, ultimately to customers, that Coles' behaviour has not changed as a consequence of category management?

MR McMAHON: No, our buyers will be in – sorry, Mr O'Donovan – our buyers will be in constant discussion with suppliers, you know, every day of every week. And, as I have said, we don't necessarily accept every proposal that's put to us. And I'm not aware of any, you know, shift as a result of our house brand.

MR TRAINOR: There'd be no fundamental shift. It would be only some of the promotional proposals that wouldn't make good sense to us at that particular time.

MR McMAHON: Good sense, yes.

MR O'DONOVAN: But are you saying that there are – as a consequence now, there are some less attractive promotional offers?

MR McMAHON: Not as a consequence of house brand. Just in general.

MR O'DONOVAN: Okay. So if we were to look, you know, statistically at how often a promotion was not back from a supplier, would we see any change in categories where house brands have been introduced?

MR TRAINOR: If you look at the frequency and amount of promotions Coles has run on any given year, I would actually argue that maybe it's the other way around that promotions have increased slightly over time in Coles. Certainly our promotional contribution, as a percentage of business, has increased and, clearly, the number of SKUs that we run on promotion over time have increased from time to time.

MR McMAHON: And that's, you know, at least in part, driven by the very competitive nature of house brands in that they cause a supplier to have to respond.

MR O'DONOVAN: All right. Now, I was planning to press on to 1 o'clock. Does that suit you?

MR McMAHON: We're in your hands, Mr Chairman.

THE CHAIRMAN: Yes, if you're happy I'm – yes, let's do that.

MR McMAHON: Absolutely.

MR O'DONOVAN: Okay. I was going to move to topics. Did you have any category management questions?

COMMISSIONER KING: Just one minor thing, and it was a comment you made, Mr Trainor. You said it's shown a 79 per cent propensity to buy into house brands in Australia. What does that mean?

MR TRAINOR: It means that, if the offer is right, and that the price is right and the quality is right, would the Australian consumer buy house brands.

COMMISSIONER KING: So was this by a survey?

MR TRAINOR: Yes, it was by a survey.

COMMISSIONER KING: Clearly not one of the ones like Choice did which you didn't like for consumer surveys before.

MR TRAINOR: In fact, it was only some data I looked at last week. In terms of its source, we could find out for you, but it was just some internal research that we'd seen last week.

COMMISSIONER KING: But, essentially, it was along the lines of asking the consumer, if the price was right, if the quality right, would you be willing to buy the house brands? Something along the lines of that?

MR TRAINOR: Yes, that's correct.

COMMISSIONER KING: Okay. I'm amazed it wasn't more than 79 per cent – given that it wasn't 100 per cent.

MR TRAINOR: Well, I think the other thing to understand in this market that, despite house brands being a part of the Australian consumer's choice since the early sixties, Australian consumers in a number of areas are very, very brand loyal. And, you know, unfortunately, from time to time Coles has launched house brands that haven't been that successful because it hasn't lived up to what the customer have looked for, and they soon tell us. So, whilst we have quoted examples today, and we have got many of them right, there's the odd one that doesn't work, and customers won't swap out of their favourite brands.

COMMISSIONER KING: I'm amazed there's 21 per cent of customers who are so loyal that if you say, look, we'll give you a better product, we'll give it to you at a better price, it just won't have the brand on there, will you buy it, and they all say no, it's - - -

MR McMAHON: But that's this point about, you know, it's not just about price.

COMMISSIONER KING: All right.

MR McMAHON: Customers make choices on a whole range of different dimensions, but price is critical.

COMMISSIONER MARTIN: Just on this issue of house brands then, you have got ALDI have their own private label, and you have got three, and Woolworths, as I understand, has got basically two. So where does it all stand in terms of comparison of quality?

MR McMAHON: Well, our – the same research that Cameron's referring to says that customer acceptance of our brands are very high, and – is that what you mean?

COMMISSIONER MARTIN: No, no.

MR McMAHON: No, sorry.

COMMISSIONER MARTIN: I'm asking for an expert opinion for the consumer. How do they judge – I think ALDI say that they have a very high value brand. So where do you rate your ones against ALDI?

MR McMAHON: Cameron, do you want to have a go at that?

MR TRAINOR: Yes, we would rate our Smart Buy products that primarily compete with ALDI. There would be a few You'll Love Coles products that would compete with ALDI depending on the quality that we would benchmark ourselves against. Against Woolworths we would have our Smart Buy products coming up against the home brand product, and our You'll Love Coles products traditionally would be up against their Select product. To our knowledge, Woolworths don't have anything to compete with Finest, and that's sort of how we would see the assessment of the market place.

COMMISSIONER MARTIN: So you're not rating the ALDI ones that highly then?

MR TRAINOR: ALDI have a – we would rate our products on an individual basis. Many of the ALDI products we would check in terms of quality. We would also argue that the items that we put up against them, whether they be a Smart Buy product or a You'll Love Coles product, would be equal to in quality, particularly our You'll Love Coles product is terrific quality.

MR McMAHON: And I should say that customers ultimately, you know, make the choice, and they rate those products very highly because, again, for different customer groups they put a higher weighting on price or value than perhaps on the packaging or the quality of the products. So, you know, we're trying to provide a range of choices to our customers.

MR O'DONOVAN: Okay. Now, moving on then to unit pricing. You indicated at the beginning in your opening that you were supportive of unit pricing. I just wanted to confirm – get you to repeat just how much you think the cost of implementation will be, and whether there are any – is there anything in terms of how it should be implemented if it's likely to ameliorate those costs?

MR McMAHON: Yes, absolutely there is. So if we could just give our position on unit pricing, and one little piece of background which is that Coles has been growing through some major system upgrades, and so we have been - up until Easter, we were implementing a new pricing system, but that system is now implemented, and we're now in a position where we can move to unit pricing on the balance of our range. As I said earlier, we already do unit pricing on a large percentage of our range. We think that, subject to the specification of unit pricing, that there's some IT costs involved, but the largest cost is the actual implementation, which is replacing the tickets on 27,000 products on our supermarket shelves all around the country. To exaggerate to make the point, if we tried to do that in one day, the cost would be astronomical. If we – but in the normal course of business we replace a lot of tickets and so, if the implementation time frame was over six or 12 months, it would significantly reduce the implementation.

So if you took, you know, a mid point and said that unit pricing was to be implemented over a period of something like 12 months, it might take us three to six months to get the IT right and, you know, six to 12 months or even longer to make sure that we get the prices on the – the tickets on the shelves. If that was the approach that we took, it would be around $10 million. If we tried to do it faster than that, it might be $20 million. And if we took a longer – you know, so it's those sorts of choices that we are making. The only other point we'd make about what's important is that the shelf ticket, you know, is prime real estate, if I could put it that way. It already has a lot of information on it. So we're very interested in getting the specification and not spending the money on IT and then having to redo it. And it's not a big space, so it has to be done in a way that actually helps customers understand it.

And so I guess, I'm there, talking about the detail of what's on the ticket. Rather than deal with that here, there's probably quite a lot that we'd like to say about the detail of what's on the ticket.

MR O'DONOVAN: Okay. So then – and in terms of its result, presumably you're supportive of it because you think it provides a benefit to your customers?

MR McMAHON: Yes, we believe that it's good for customers. I actually think it will help our house brand sales, because it will demonstrate even more the value that's in those brands. So, as we have said along, we're in favour of greater transparency for customers, and if you're in a position where you aim to be price competitive, we have no problem with demonstrating it.

MR O'DONOVAN: Okay. Which I guess raises the question of why, if it's of benefit to customers, it hasn't been introduced voluntarily.

MR McMAHON: Well, I guess two things. One is, as I said, our systems platform has only just got in the position where we believe we can do it. Secondly, we're now under new ownership and we have a different view of life. And I think there is a view – we would have a view that, if it's good for our customers, it's – why isn't it good for all retailers customers, and that if we're going to spend that sort of money, you know, we don't want to be at a disadvantage to others. And actually the main concern there is spending the money multiple times. So we don't want to be in a position where we voluntarily spend the money, put it in place, and then find that a different standard is imposed and we have to re-spend the money.

MR O'DONOVAN: Okay. So am I right in saying that your support for unit pricing is qualified in the sense that you would like to see it mandatory for all retailers to ensure that - - -

MR McMAHON: We would prefer to see it for all retailers, yes, because otherwise it adds the costs for some and not for others, and because, as we have said earlier, you know, there are a number of players out there who are not as price competitive – well, let me put it in the positive. I think it will demonstrate just how price competitive we are. But, you know, we would intend to do unit pricing anyway.

MR O'DONOVAN: Right. So regardless of whether or not the government proceeds with mandating unit pricing - - -

MR McMAHON: Well, the only qualify there is that we're a bit caught in the middle here because we don't want to spend the money and then have something different mandated in six months or 12 months, because that doesn't benefit us and doesn't benefit our customers. So if there's going to be a standard we'd prefer to know what the standard is and then we spend the money once and get on with it.

MR O'DONOVAN: Okay. Right. I think we might - - -

THE CHAIRMAN: The fact that ALDI is already proceeding with it and Woolworths indicated last week that it was proceeding with doesn't provide an incentive for you to proceed in any way?

MR McMAHON: Absolutely. It's a competitive market. We're responding.

COMMISSIONER KING: Just one follow up on that. Does unit pricing cause any difficulties with your managerial discretion that you have at the local store level? In other words, is there an extra cost if a manager needs to go and drop a price to match a competitor? Does unit pricing cause any problems with that?

MR McMAHON: It wouldn't cause a problem, we just have to redefine our policy just so that it's not only the shelf ticket price, but also the price per 100 grams or price per kilo, or whatever the standard is. So, no, I don't see it as adding a burden. And I'd just make the point that the ongoing – we replace tickets all the time. So, in a way, the ongoing costs aren't the issue. It's the speed of implementation which will dictate the cost.

THE CHAIRMAN: Yes, just to make that a bit clearer, because I think you indicated that the 12 month period, which was the $10 million cost, was reflective of a number of items. Getting your IT system set up, getting the standard specifications right, and then the pace with which you change tickets.

MR McMAHON: Correct.

THE CHAIRMAN: I was actually going to query that, that that seemed to suggest in that there was, what, a six, to nine, to 12 month period over which you would change tickets in the normal course?

MR McMAHON: Well, in the normal course, obviously, on our promotional lines and on the key lines, the tickets probably change several times a year. Possibly even in a month. But on some of our other lines the prices may be more stable and not change for quite some time. All we're flagging is that, if I sent a team out today to change over 27,000 shelf edge tickets in 749 supermarkets, that would be a big cost, $20 odd million. If we were able to just do it in the normal course of business it's still an incremental cost, but by no means as large. And we think the timelines, you know, from go to woe is probably around 12 months.

THE CHAIRMAN: All right. You want to break now?

MR O'DONOVAN: Yes.

THE CHAIRMAN: Until?

MR O'DONOVAN: Five to two I think.

THE CHAIRMAN: Yes, five to. Well, let's – we'll round it out to 2 o'clock and give you another five minutes.

MR O'DONOVAN: Thank you, Mr Chairman.

ADJOURNED [12.59 pm]

RESUMED [2.07 pm]

THE CHAIRMAN: All right. We'll resume the hearing. Now, Stephen King, you've got a couple of questions. This relates to these two supermarkets in Canberra.

COMMISSIONER KING: Yes, Mr McMahon, just earlier on today I asked about a couple of specific supermarkets just so that perhaps we can get a better handle of what pricing differences exist and I mentioned a couple, one in Jamieson Centre in the ACT where a Coles is almost next store to an ALDI and one in Belconnen Mall in the ACT where a Coles and Woolworths are present but there is no ALDI, as far as I'm aware. Now, have you been able to check, are they in different pricing zones?

MR McMAHON: No, they're in the – I can confirm they're in the same price zone.

COMMISSIONER KING: Okay. So, does that mean that in terms of the unit prices that those two Coles stores, they would be starting at the same level?

MR McMAHON: Give or take before you get to local competition, depending on who's in closer competition.

COMMISSIONER KING: Okay.

MR McMAHON: For, as you've said, Belconnen, Jamieson, the only other thing I would throw in is that about five kilometres away is another Woolworths and ALDI at Kippax Fair, I think. So, they're probably the three that play off each other.

COMMISSIONER KING: Okay. Again, this may get into too much specific detail but at a general level, what sort of local price differences would I expect to see between the Coles in Jamieson and the Coles in Belconnen, are you able to – so, give me a feel, if I went in there and I said, "Which prices would I see cheaper in Jamieson compared to Belconnen or vice versa?"

MR McMAHON: Well, the first thing to say is that because they're in the same price zone, we would expect to see them, as you said, start at more or less similar prices and then the local competition policy across 330 products might mean that the store manager in Belconnen, for instance, is matching the price of a butcher out the front or the price of bananas with a fruiterer closer to their store. Those sorts of differences. I can't comment specifically but there is the opportunity for quite some variance in prices based on that more specific local competition.

COMMISSIONER KING: So, the Jamieson Centre would – you've mentioned already the relationship between Smart Buy, You'll Love Coles and the home brand products of ALDI. Would we or again speaking generally, would we expect to see the home brand products at the Jamieson store would likely be cheaper than the equivalent product at the Belconnen store because of the proximity of the ALDI?

MR McMAHON: I don't believe so because - - -

MR TRAINOR: They would be in the same price zone.

MR McMAHON: - - - they would be in the same price zone, yes.

COMMISSIONER KING: Okay. So, if there wasn't an ALDI within the price zone, would we then expect to see differences in the Smart Buy prices and the You'll Love Coles prices compared to a zone where there is an ALDI present?

MR McMAHON: Sorry, if I can just understand the question.

COMMISSIONER KING: Sorry.

MR McMAHON: If – no, that's okay. If there was – if a supermarket was in a zone with no ALDI, would there be differences, yes, I think there would.

MR TRAINOR: Yes, there would be some.

COMMISSIONER KING: What sort of differences if you're able to say?

MR TRAINOR: There would be some approximately on the 800 house brand items that we would compete against and they would vary, depending on any given week, of course, but those house brand items would vary between an ALDI price zone and a Woolworths price zone marginal.

COMMISSIONER KING: Okay. And by vary, I assume you mean they'll be cheaper in the ALDI price zone?

MR TRAINOR: Yes, traditionally it would be.

COMMISSIONER KING: Okay. Are you able to give us any idea of how much cheaper they would be, are we talking about a fraction of a per cent or are we talking about a number of per cent, two or three per cent?

MR McMAHON: Well, we would say that it's quite a mix and that's probably an answer that's best answered in the detail or by looking at the data.

COMMISSIONER KING: Okay.

MR McMAHON: And I think we've provided an awful lot of data but we can have a look also at how much that varies. I would say that just generally, again I was just making sure I had a look at this in the last week or so, but typically between those price zones there may be different prices on around 200 to 220 lines. So, in terms of 27,000 SKUs it's not that many, typically. I'm talking averages here. But, of course, they do tend to be on the ones that matter to customers, as we said earlier.

COMMISSIONER KING: Okay. But just on the public record, you're not able to give us a feel for, sort of, an average reduction on those Smart Buy products?

MR McMAHON: No, I can't, no. I would be guessing, yes.

COMMISSIONER KING: Okay. Just something else, whilst we're on the house brands and the Smart Buy and the You'll Love Coles, as I understand your evidence earlier today, in general the Smart Buy would be a cheaper but lower quality than the You'll Love Coles, is that a correct statement?

MR McMAHON: We put it the other way which is that Smart Buy is excellent quality and You'll Love Coles is better.

COMMISSIONER KING: Okay. Well, taking bit of an excellent as being a higher quality and Smart Buy as being a lower quality than the You'll Love Coles - and generally the You'll Love Coles will be at a higher price point than the Smart Buy, is that right?

MR McMAHON: Generally speaking, yes.

COMMISSIONER KING: Okay. Now, if we just pick a price – let me pick, let's say, milk as a generic product or as a product that you can buy – I think Coles have both the Smart Buy milk and the You'll Love Coles milk?

MR McMAHON: Yes, we do.

COMMISSIONER KING: Okay. So, for those two particular products, is there a difference in quality between the two products?

MR McMAHON: There is in the eyes of the customer, interestingly enough, that the – and David can comment in a bit of detail here. But for milk, our specification for – remember that there's a product spec that backs up each of these products and it could be the quality of the product itself, it could be the sourcing of the product, it could be the packaging of the product and obviously then to the price of the product.

COMMISSIONER KING: Okay. So - - -

MR McMAHON: With milk, the key difference is in the sourcing. So, generally speaking – and there are some markets where it's a bit hard to do for drought and other reasons – but generally speaking, we source You'll Love Coles milk in the local area, local being at least within the State, and Smart Buy, our suppliers can source that product anywhere and our customers, you know, attach a value to knowing that they are supporting local farmers, local production. David, would you add to that in terms of the differences in the spec – and then you get into pricing and other things.

MR STEVENS: No, that's it. So, it's communicating that the You'll Love Coles is sourced from your state has been the specification difference between that and Smart Buy.

COMMISSIONER KING: Thank you.

THE CHAIRMAN: Are you being serious?

MR STEVENS: Yes.

THE CHAIRMAN: What, that what percentage – I assumed you've done a market survey. What percentage of your customers would differentiate as to the source of the milk in relation to those two different brands or packaging?

MR STEVENS: I can't give you the answer. We haven't done a survey on that but in terms of the seriousness of how important sourcing is, there are many examples where sourcing is the value add. So, it might be that we source specific products within fruit, within canned fruit, that is Australian and then we source other product that is not Australian and the value add is calling out this is Australian, relative to non-Australian.

THE CHAIRMAN: I can understand that for Australian and non-Australian, but I'm just interested, what you've indicated is that you price differentiate between Smart Buy and You'll Love Coles milk on the basis that consumers will value add for the "local product", which I assume means that, in Melbourne, it's from somewhere in Victoria but the Smart Buy may come from New South Wales or Queensland or whatever. And you're saying to me that although you've never done a consumer survey on this issue, you believe that there is a consumer point of differentiation, a consumer point of value adding that leads consumers to paying a higher price for the You'll Love Coles branded milk or packaged milk as distinct from Smart Buy.

MR STEVENS: Yes.

THE CHAIRMAN: And how do you establish that if you have not done a survey?

MR McMAHON: No, I think, if I can say, I'm sure there's been plenty of customer research done. I think what David said is, is he's not familiar with that and as I said, there's a range of product differentiators. I'm saying that within milk, that is a key one for our customers, knowing the source of the milk - - -

THE CHAIRMAN: And you've done some customer research on this?

MR McMAHON: I would imagine that we have. I haven't seen it personally but I would imagine that we have. This product has been in the range for a number of years.

THE CHAIRMAN: And, just so as we understand, the price differential on average, retail price differential between You'll Love Coles and Smart Buy in milk will be of what order, what percentage, just roughly, just on the normal - - -

MR STEVENS: Two litre - - -

THE CHAIRMAN: Not normal - - -

MR McMAHON: Full cream, whatever - - -

THE CHAIRMAN: Whatever, normal milk.

MR STEVENS: Around 20 per cent.

THE CHAIRMAN: 20 per cent?

MR STEVENS: Around 20 per cent.

THE CHAIRMAN: Yes, 20 per cent.

MR STEVENS: Yes.

THE CHAIRMAN: And where would the customer find the source of the milk, on the package, how would they know where the milk was sourced?

MR STEVENS: Well, it would be on – our intention that it would be on point of sale rather than packaging and in the last year because of draught and the inability to source, everything from the State, we have not been able to communicate that message. But it has been and it would continue to be our intention that You'll Love Coles was 100 per cent sourced from the State where that was achievable.

THE CHAIRMAN: And Smart Buy would be?

MR STEVENS: More flexible in sourcing.

THE CHAIRMAN: Right. But if there was Smart Buy milk that was sourced from the State in which it was being sold, would it be sold at 20 per cent less than the You'll Love Coles milk, so the same source, same quality, I presume the same cow, different packaging?

MR STEVENS: Yes, so Smart Buy would be the lowest in the State and You'll Love Coles would be differentially priced on that instance.

THE CHAIRMAN: Yes. And that would be based on, what, different cost, same cow?

MR McMAHON: Yes, but there – you're looking at it end to end which is right. We're looking at it in terms of the arrangements we have with our suppliers. If we provide the certainties to suppliers that they can source that product anywhere, they provide us with a better price. That's how it works. Now whether they ultimately use that flexibility or not is up to them. It's not something for us.

THE CHAIRMAN: But the reality is, isn't it, is that it's a marketing ploy, it's a marketing packaging exercise?

MR McMAHON: Well, I think there - - -

THE CHAIRMAN: Because I think you actually gave a very honest answer in your immediate reaction to Dr King's question, which was that the consumer sees a difference.

MR McMAHON: The consumer sees a difference but I also would take you to – and as I say, we're focusing on source but there's packaging differences and a range of, you know, milk fats, milk solids as you get into our wider milk range.

THE CHAIRMAN: No, we're dealing with standard milk.

MR McMAHON: Sure. That's fine.

THE CHAIRMAN: Yes.

MR McMAHON: Then the other key factor is the supplier end. So, if a supplier knows that they have to put in a tender price for the supply of milk and that the source of that supply is constrained, as in your example, to Victoria, that will have one impact on their economics. If they know that they can shift surpluses from other States, then that will have another one. And so that leads to different pricing in our cost of goods, even before it gets to the customer. So, you've got to look at, you know, all the way through.

THE CHAIRMAN: I won't embarrass you by doing a consumer survey of the people present in this room to see whether they care whether their milk comes from New South Wales or Victoria but - - -

MR McMAHON: Well, that's a trap in retail is to assume that what we think is what the population thinks, but – yes.

THE CHAIRMAN: Yes. All right.

MR O'DONOVAN: Okay, all right. Now, you have already indicated that you do local pricings and presumably that means that the structure of the local market has definite impact on how you price the local level. I understand you correctly?

MR McMAHON: Yes. Well, we're obviously, in a day-to-day sense, focused on the behaviour in the market, that the behaviour will be driven by structural issues.

MR O'DONOVAN: Yes. And that includes the structure at the local level, not just at a broader level?

MR McMAHON: Yes, that's right.

MR O'DONOVAN: Okay. So anything that would keep out additional competition at the local level is likely to be something that will give you some advantage, in terms of either the pricing in your store or the profitability of that store. That would be right?

MR McMAHON: I would just put it the other way. We're happy to compete. What we want to do is compete on a level playing field.

MR O'DONOVAN: Sure. But to answer my question, if you're able to keep the competitor out at a local level, that will be of advantage to you?

MR McMAHON: I'll say yes, I think. I'm not quite sure. There's lots of ways that advantage can play but I think we have heard earlier that if an ALDI opens up next to us, that it can add customer count to the shopping centre and actually help us. So I'm not quite sure it's as simple as that. But if you're dealing with economics as opposed to customer behaviour, then I'll agree with your point.

MR O'DONOVAN: Okay. All right. So then in relation to restricting competitor access to suitable sites near a Coles, you have got an economic incentive to keep them out of an area if you can?

MR McMAHON: I think the answer to that is yes.

MR O'DONOVAN: Yes. All right. So, now we heard from Woolworths last week that they would lodge planning objections in areas where they didn’t have any presence at all, but where they could obtain some commercial advantage by doing so. I don’t think I’m being unfair to them in saying it in that way. Does Coles have the same strategy, that it will lodge planning objections on the basis that it delivers to them some either delay or full prevention of competitive entry at the local level?

MR McMAHON: I’ll ask Tim to comment on that. But to my knowledge, we have had something like 20-odd objections out of 350 or 400 new stores built over the last few years. But, Tim, do you want to give more - - -

MR BOYCE: Yes. I think in response to that question that would be an extremely rare occurrence. As Mick said, there’s been, you know, in excess of 100 new Woolworths stores in the last five years. We have had a lot of evidence in how many ALDI stores have been put into the market place, plus IGA etcetera, over the last five or so years. And we can really only find, you know, around about 20 cases where there have been objections lodged. In at least half of those cases it was by landlords as opposed to ourselves. Landlords presumably protecting their economic interest. So it’s certainly not part of our standard process.

MR O'DONOVAN: Right. But it does happen?

MR BOYCE: It happens occasionally.

MR O'DONOVAN: Okay. And in terms of the – and what is the process by which it happens? Presumably it has to be authorised at a certain level to lodge a planning objection. Is it done at the store level, is it done - - -

MR BOYCE: It’s certainly not done at the store level. It would normally be authorised by the state property manager, or whatever terminology we might use, from time to time. And they would do it generally on the basis that it was recommended to them from one of the state leasing operatives.

MR O'DONOVAN: Right. And the basis for that recommendation would be that it held out, delayed or prevented competitive entry by someone?

MR BOYCE: Not really, no. I mean, in a lot of cases - - -

MR O'DONOVAN: Sorry, just let me stop you there. In any cases, would that be the basis for the recommendation?

MR BOYCE: Occasionally, I'm sure it would be, yes.

MR O'DONOVAN: All right. So when you say occasionally, how many are we talking? One a year, three a year, five a year?

MR BOYCE: Any of those numbers could be right. And in a number of cases, I'm sure it's recommended and we don't proceed with it.

MR O'DONOVAN: All right. So in terms of the last 12 months that you're aware of, how many would you say have proceeded – how many planning objections have proceeded on the basis that the effect will be to delay or prevent competitive entry?

MR BOYCE: Are you talking about by Coles directly, or by landlords?

MR O'DONOVAN: Well, let's stay with Coles directly.

MR BOYCE: So Coles directly, without knowing the numbers specifically, I wouldn't imagine it's any more than about a dozen.

MR O'DONOVAN: Okay. And in relation to landlord initiated ones?

MR BOYCE: I don't really keep track of that.

MR O'DONOVAN: Okay. But Coles does support applications by landlords?

MR BOYCE: If landlords come to us and suggest that we should provide some support and support's a broad term. In a number of cases they might just say to us "We're going to launch an objection. Do you have any problem with that?" We would say yes or no. But on occasions - - -

MR O'DONOVAN: But if we put the threshold a bit higher and say, in terms of Coles itself putting the written submission to support the landlord's objection?

MR BOYCE: We wouldn't normally do that.

MR O'DONOVAN: Okay. Is there any obligation on the landlord? Does Coles ever impose an obligation on the landlord to make an objection?

MR BOYCE: Not knowing the detail of everyone of our leases, but very rarely.

MR O'DONOVAN: But it does happen?

MR BOYCE: To the best of my knowledge, I can't think of an example in a lease where it does happen.

MR O'DONOVAN: Okay. And you personally haven't included one in the last 12 months?

MR BOYCE: Not to my recollection, no.

MR O'DONOVAN: Okay. Well, have you checked for this kind of thing?

MR BOYCE: Yes, we have.

MR O'DONOVAN: You have. Okay. All right. Now – so now, a few years ago, at least in relation to liquor licenses, the Commission brought a case against Coles for effectively using the liquor licensing process as a means of preventing or restricting entry by competitors into the local liquor markets. Are you aware of that?

MR McMAHON: Yes. I am, yes.

MR O'DONOVAN: Yes. All right. Now, since that case, has the company's practice changed so that it no longer uses the objection process in that way? Or has it simply stopped – ceased settling the matters in the way that was ultimately found to be contrary to the Trade Practices Act?

MR McMAHON: The actual practice which led to the case predates my time with Coles. But I was aware of its resolution in the end with the Commission and certainly our practice has changed. Absolutely.

MR O'DONOVAN: All right. So is it no longer the practice to object to liquor licences in New South Wales, as a matter of routine, to block competitor entry?

MR McMAHON: Certainly as a matter of routine. And I'm only aware of two objections in the last two years in New South Wales. I'm not aware of the detail of them but certainly our practice has changed from the circumstances that gave rise to the matter you mentioned.

MR O'DONOVAN: Okay. Now in terms of the circumstances where you do make an objection. What's the process for approving the making of such an objection?

MR McMAHON: Typically it would be along the lines that Tim has described, where within our liquor business we had a property or a development manager who would make judgments from time to time as to whether to lodge such an objection. If you look at how many objections have occurred, there have been very few in the last couple of years.

MR O'DONOVAN: And what distinguishes those cases where you have objected, from ones where you decided not to object?

MR McMAHON: Primarily - and I'll be talking generally here – but, as I said, they're only in New South Wales. A couple in the last two years. I would say generally it's where it affects the customer amenity of our location or the business. The business impact on our investment. But I would have to dig out the couple of examples. As I say there's only two that I'm aware of in New South Wales. We can have a look specifically.

MR O'DONOVAN: Right. So when you say it affects the business, doesn't that effectively mean that if – well, does that mean that if you notice a competitive impact, I mean a competitive impact will affect your business.

MR McMAHON: Sure.

MR O'DONOVAN: That that would provide the basis on which you'll object?

MR McMAHON: Yes. I think, and again I'm no expert on the detail of the New South Wales liquor planning process, but essentially it's been a needs test and therefore there are grounds within that as to whether the local needs another liquor outlet. But I'm talking in the general here and it may help for us to dig out some information and answer in the specific, if that helps.

MR O'DONOVAN: Okay. But can you rule out – as you sit here, can you rule that objections are made for the purpose of solely protecting Coles' competitive position in the local market?

MR McMAHON: I can't rule it out because I'm only familiar with the last couple of years. In the last couple of years we have had very, very few objections. As I said, two in New South Wales. I know in the last 12 months we had two in South Australia and I think that was it, nationally. I can't comment back before that because I wasn't with the business.

MR O'DONOVAN: Sure. But in the last couple of years, are you saying that it's still possible that in the last two years there have been objections solely for the purpose of blocking competitive entry into a local market in which Coles is operating?

MR McMAHON: Yes. It's still possible. As I say I should dig out the two examples in South Australia and two in New South Wales and we'll have a look.

MR O'DONOVAN: All right. Okay. Now, I think it's the suburb Tooronga, there's currently a development underway, I think being constructed by Stocklands. Is that right?

MR McMAHON: We're very familiar with that one because it's right next door to our office.

MR O'DONOVAN: Right. Okay, good. Now, in relation to that, firstly, that there's an existing Coles store on the site, is that right?

MR McMAHON: There was. Tim can take you through this, but it closed a month or two ago and at the moment it's a building site. But, Tim, do you want to - - -

MR BOYCE: At the moment, yes. It’s the shop that - Coles store closed on 14 March and at the moment the site is boarded up and it’s half way through being demolished.

MR O'DONOVAN: Okay. And the plan is to use it and some adjoining land to build a much larger development, is that right?

MR BOYCE: Correct. So Stockland own what we call all of the land on the top site and all of the land on the bottom site, which is otherwise known in the public as the brickworks site, to develop a retail centre with a Coles store, First Choice Liquor store and 30 or 40 shops. And effectively the balance of the rest of the site for other commercial and a significant amount of residential.

MR O'DONOVAN: Okay. Now, I understand that in terms of the size of the shopping centre that’s going to be developed, what will be the gross lettable area, how big a shopping centre are we talking about?

MR BOYCE: Off the top of my head it’s probably about 8000 square metres. Somewhere less than 10,000 square metres - - -

MR O'DONOVAN: All right.

MR BOYCE: - - - which in terms of how that’s balanced up would be a Coles store of just less than 4000 I think, liquor store about 1000 and then the rest of it – you normally get about one specialty store to every 100 square metres worth of retail. So that adds about another 4000 metres worth. So that probably has it at around 9000 metres.

MR O'DONOVAN: Okay. And in terms of the landlords freedom to lease some of that space to a supermarket, are there currently restrictions on the landlord’s ability to do that?

MR BOYCE: I think we’re potentially getting into areas where we might need to go in Canberra.

MR O'DONOVAN: Okay.

MR BOYCE: Yes.

MR O'DONOVAN: All right. So there’s nothing publicly available that would indicate - - -

MR BOYCE: Well, in terms of publicly available, because the leases in Victoria aren’t registered, it’s not on the – a lease that would exist for that premises isn’t on the public record.

MR O'DONOVAN: Okay. All right.

THE CHAIRMAN: But if we were in any other state, it would be on the public record?

MR BOYCE: It would be, yes.

THE CHAIRMAN: Yes. And you still wish to preserve confidentiality in respect of this one, even though if the law were the same in this state, it would be on the public record? It's that sensitive?

MR BOYCE: It's that sensitive only in the sense that Stockland own the site and we have confidentiality obligations to them. But also because it is in an unusual position of being in between leases, it's half way demolished and so we're not actually operating on an existing lease at the moment.

MR McMAHON: And also we're happy to take you through in confidence - - -

MR BOYCE: In confidence.

MR McMAHON: We're happy to approach Stockland and see if they're happy to release the details.

THE CHAIRMAN: Well, we might do that is do it in confidence and then approach Stockland to see if they will release the confidentiality if you have got no objection to that and then we can release that part of the transcript into the - - -

MR McMAHON: Yes. We'll discuss that with them.

MR BOYCE: Yes. That's fine.

MR O'DONOVAN: Now, as a consequence of the rebranding of BI-LO it has become necessary to close some BI-LO stores. Is that right?

MR McMAHON: In any given year we do close a number of supermarkets and certainly the rebranding of BI-LO has led us to close or sell in fact a number.

MR O'DONOVAN: Now, I think Chirnside in Queensland, Tea Tree Plaza, there were two BI-LO stores closed.

MR BOYCE: Chermside.

MR O'DONOVAN: Chermside.

MR BOYCE: And Tea Tree Plaza, yes. So Queensland and South Australia.

MR O'DONOVAN: In both those cases leases were surrendered?

MR BOYCE: To my recollection, yes, they were.

MR O'DONOVAN: Okay. And in both those centres there are Coles stores left behind in those centres?

MR BOYCE: That's correct. Yes.

MR O'DONOVAN: And it was a condition of surrender, was it not, that the development or the shopping centre owner could not lease those premises to supermarkets over 1500 metres, so effectively it could not replace the BI-LO with an additional large format supermarket.

MR BOYCE: That’s factually correct in both of those circumstances. I think in both of those circumstances with Chermside and with Tea Tree Plaza, there was a sizeable amount of evidence to suggest that three full range supermarkets couldn’t operate profitably together in shopping centres of that size.

MR O'DONOVAN: All right. But nonetheless, Coles, rather than leaving that to the commercial judgment of any independent that might want to set up, made sure that it was in fact impossible for an independent large format supermarket to operate in that area.

MR BOYCE: I think we came to that agreement with the landlord.

MR O'DONOVAN: Sure. But it was Coles’ initiative?

MR BOYCE: I wouldn’t necessarily suggest that it was Coles’ initiative.

MR O'DONOVAN: That landlord volunteered a restriction on itself?

MR BOYCE: I think we just reached a commercial agreement which amongst other things would have included the amount of money that we did or didn’t pay to leave that store at the time.

MR O'DONOVAN: So were you involved in those specifically?

MR BOYCE: Yes.

MR O'DONOVAN: Do you recall who proposed that restriction?

MR BOYCE: I can't recall off the top of my head, no.

MR O'DONOVAN: If you had to make a guess?

MR BOYCE: If I had to make a guess it would more likely to have been us than it would have been to have been in both cases Westfield.

MR O'DONOVAN: All right. Now then, in relation to Katoomba in the Blue Mountains, Coles is – there is currently a Franklins store in Katoomba?

MR BOYCE: There is, yes.

MR O'DONOVAN: Stop me if anything that I say, if I'm going to reveal anything confidential. I don't think that I am, but we were advised by Franklins that Coles is now its landlord?

MR BOYCE: That's correct. Yes.

MR O'DONOVAN: And Franklins' lease expires in 2013?

MR BOYCE: As I understand it, yes, it does.

MR O'DONOVAN: Now, is it presently Coles intention to renew the Franklins' lease?

MR BOYCE: We might get confidential here but Katoomba is I'd say quite an interesting story in terms of how retails evolved in Katoomba so immediately adjacent to the site that you are talking about is a Coles and Kmart, what used to be a super Coles and Kmart based centre, well, in fact it's only Coles and Kmart. That's owned by Woolworths and Woolworths bought that a number of years ago. As I understand it, thinking that our leases expired in 2007 when in fact they expired in 2012 but – but on the other side of the Franklins site, what is known as Katoomba Fair, is some council land, some other shops and a site called Katoomba TAFE where Coles have entered into a joint venture arrangement with the local council to build a shopping centre and a cultural centre.

So in terms of, is it Coles intention to renew Franklins lease or not, their lease expires in 2013 but until such time as we finalise the dealings on what is know as the TAFE site, I can't tell you whether we have an absolutely unequivocal position on the Franklins lease at this stage.

MR O'DONOVAN: Okay. Would we be able to explore that more on a confidential basis?

MR BOYCE: Absolutely.

MR O'DONOVAN: All right. Now, in relation to the leases which Coles entered into there is a fair proportion of them which prevent second or third tenancies so we say that there'll be a rent reduction if the landlord introduces a second supermarket into the area. And is Coles aware that there is some risk in respect of the Trade Practices Act when it entered into those kinds of clauses?

MR BOYCE: Yes, we are aware.

MR O'DONOVAN: So it has a policy to give proper consideration to the necessity for those particular provisions?

MR BOYCE: Yes, we do.

MR O'DONOVAN: Can you tell us what is the process for including those provisions in it? It’s not automatically done or done ad hoc by the negotiators. What process is there for assessing whether or not those restrictive covenants breach the Trade Practices Act?

MR BOYCE: I think it probably goes to the point of who it is we are negotiating with so we have what is called a standard lease. A standard lease would generically have one of those clauses in it, but a standard lease is what we call a base document and from that base document from time to time we will negotiate additional clauses in and a number of clauses out. So that would be in circumstances where it’s in the interests of the developer and ourselves to use a base document or a standard document. So we also have standard documents with a number of major landlords and generically in those standard documents there is no such clause and then in terms of the policy of when that clause is included or not included, really it gets down to the decisions that we make with the landlord and during the balance of the commercial negotiations.

MR O'DONOVAN: So there is no attempt to assess whether as a matter of fact that if another supermarket is excluded from this particular location it will lessen competition in the local area. There is no formal process for doing that?

MR BOYCE: I think what we do when we’re assessing any individual site is, we have a look at what the competitive environment is in that local area and so we’re making our decision on whether we take a new store on the basis of what that competitive environment is. And so in a number of cases we don’t feel that we need that clause. In a number of cases the balance of our commercial judgment says that that clause should be included and in those circumstances I think we would consider that it would breach any competition policies.

MR McMAHON: Well, more than that. We make sure it doesn’t so all such leases need to go through legal before myself or Terry would sign them. So we make absolutely sure that we are not in breach of any regulation.

MR BOYCE: So we’ve got what we call a capital investment forum which approves all new lease deals, and then before it goes to the directors to be signed off, it will go through a commercial sign off and a legal sign off.

MR O'DONOVAN: But in order to give legal sign off on one of those you would actually have to understand what the local market conditions are and it’s not simply a matter of just putting a document through legal. Is there any formal process by which legal are informed of what the local competitive environment is so that they are actually in a position to say whether or not that clause substantially lessens competition?

MR BOYCE: I think the legal team aren’t just – and they are predominantly an internal legal team within Coles – they aren’t just a part of a sign off process but we consider them to be an integral part of our negotiating team. So they will be aware of the papers that are put to the capital investment forum which, amongst other things, have market assessments included in them and those market assessments will talk about the predominance of competition within the area and then the leasing operative and the lawyer from time to time will discuss what the elements of that local competition is with an aim to the lawyers being able to provide legal sign off.

MR O'DONOVAN: Well, to your knowledge, has legal ever told you that such a provision would breach the Trade Practices Act and ought to be removed on that basis?

MR BOYCE: Not that it would breach the Trade Practices Act but they have in a number of cases suggested that such clauses not be included.

MR O'DONOVAN: Did they say, and again I only want to your recollection. I don’t want any extrapolation. To your recollection did they say why?

MR BOYCE: No.

MR O'DONOVAN: So would you agree that it’s quite possible that for commercial reasons one of these clauses will be included notwithstanding that if a proper assessment was done of the local market the consequence may be that it would substantially lessen the competition.

MR BOYCE: Can you just – sorry, just repeat that question?

MR O'DONOVAN: Sure.

MR BOYCE: Add a few parts to it.

MR O'DONOVAN: Yes. Okay. Well, the first part is that the clause is included in the lease for commercial reasons. Okay?

MR BOYCE: Yes.

MR O'DONOVAN: So there’s a commercial case for its inclusion. Notwithstanding that there are good commercial reasons for it, it may lessen competition in the market in that the landlord who would grant a lease to a competing supermarket now won’t and that has the effect of lessening competition in the market place.

MR BOYCE: I would say that is possible but unlikely.

MR O'DONOVAN: Right. But would you agree that your processes are not well adapted to picking up whether or not these clauses do lessen competition in a market?

MR BOYCE: I think our processes are robust in the sense that there are able to address all of the competitive issues in the market place but to the degree that in isolated cases the legal team aren't necessarily across the competitive issues of the market place because we as commercial operatives haven't made them – haven't brought them across those issues and there is a chance that that could be the case.

MR O'DONOVAN: Right. Now, I notice that in terms of the thresholds for the size of a supermarket that's locked out that your thresholds are quite low, 500 square metres routinely. Is that your understanding?

MR BOYCE: So somewhere between – in a number of cases 500 square metres, 100 square metres, 1500 square metres. The standard lease correct as 500 square metres.

MR O'DONOVAN: Yes, okay. Now, obviously the competitive effect of locking out 500 supermarkets below 1500 square metres would have been different before the advent of ALDI.

MR BOYCE: That's correct, yes.

MR O'DONOVAN: Okay. Have you modified your standard documentation or your legal process since the introduction of ALDI to the market?

MR BOYCE: We haven't modified the standard document, no. I think the only thing I would say to that is that we have substantially fewer of those clauses in our leases now than we would have going back, you know, 10, 15 years.

MR O'DONOVAN: Right, and that's because landlords won't accept them or because Coles has stopped asking for them?

MR BOYCE: That's because in – it's a combination of both.

MR O'DONOVAN: So in what circumstances would Coles initiate removal of the clause?

MR BOYCE: In circumstances where we didn't necessarily think that there was really any point in having the clause in the lease in the first place because the constraints of the site were such that really there was, you know, just no point in having the clause in the lease in the first place.

MR O'DONOVAN: Okay. So that - - -

MR BOYCE: And in a number of other cases where there was a decent chance that – because all we're doing is applying those clauses to the centre or the site in question, and there might be a number of retail opportunities in a market place and we've already had the conversation around an ALDI or other parties being complementary retailers that in terms of foot traffic and foot fall you would rather have competition with you than somewhere else.

MR O'DONOVAN: Okay. So in the last 12 months have you specifically removed such a clause with a view to getting ALDI into a centre?

MR BOYCE: I can't talk for the last 12 months, but in at least four or five specific examples that we can give you in camera, yes, we have – well, I won't say removed the clause but the clause has been in existence in the lease and, regardless of whether the clause was there or not, we have been happy for ALDI to come into the centre.

MR O'DONOVAN: All right. Did you – well, perhaps it's easier to pursue it in camera but I'll ask it just so I don't forget. In those circumstances did you seek anything in addition from the landlord, or was it – did you simply not enforce the clause?

MR BOYCE: Look, I think that would either be in camera, or I'm not entirely certain.

MR O'DONOVAN: All right. Now, Coles also acquires freehold sites when it - - -

MR BOYCE: Correct.

MR O'DONOVAN: - - - has a view to developing an area. Now, does it ever acquire a site knowing that it will effectively cannibalise the business of an existing Coles, as in take away customers from another Coles store close by?

MR BOYCE: In a narrow sense, yes. So we will on occasions buy freehold land where we know that by putting a supermarket there there is going to be an impact, a financial impact, on one of our other stores. So, you know, if for want of a better term that's cannibalising our existing store network, then on occasions we will, yes.

MR O'DONOVAN: Okay. And then just expanding that from just in addition to acquiring land, entering into I suppose negotiations with the landlord to open a supermarket or even acquire an existing supermarket to convert it to a Coles, do you also do that in circumstances where it's likely to attract business away from a nearby Coles?

MR BOYCE: I think – I mean, that is a standard part of the process that any retailer will go through to secure new opportunities. It's very rare in the market that we've got these days where you put a store on the ground and it doesn't have an impact in some manner or form on your existing network.

MR O'DONOVAN: Sure. Would you ever have impacts of 30 per cent of turnover might be taken from one store, from an existing store and introduced to a new store?

MR BOYCE: Far less likely that there is a 30 per cent impact from us putting a store in the market than there would be for a competitor putting a store in the market.

MR O'DONOVAN: Okay, but let's stick with that question, not about likelihood. Are there circumstances where you have opened a store where the effect would be that it would reduce an existing store turnover?

MR BOYCE: Yes, there are.

MR O'DONOVAN: Okay, which suggests that you are placing an additional store effectively into the same local market if it's taking - - -

MR BOYCE: So, yes, into the same – what we would call primary trade area versus secondary trade area, we will occasionally put stores inside the same primary trade area. I think you have to balance that up against the fact that our job – and my job more specifically for the customer is around convenience. And so if Coles wants to have the best stores in the best locations and if in that circumstance that store is in a better location than the existing store, given that we enter into leases for 20 years, I want to be in the best location; and Coles wants to be in the best location for our customers.

MR O'DONOVAN: Sure, but you would continue to operate two stores then in that location?

MR BOYCE: For periods of time we will, and then when the lease expired on one of the stores we would make an assessment at that period of time as to whether we still wanted to be there or not. If we had shorter lease terms and more options at our disposal, it would be a lot easier for us to be able to manage our way in and out of individual stores and locations.

MR O'DONOVAN: Sure, but in making the decision to stay on once the lease has expired, there is a significant incentive for Coles to block a competitor to enter on that site if it's a good site that will compete directly against your other Coles store, isn't it?

MR BOYCE: If it's a really good site, then inevitably we will be making really good money out of that really good site in which case it's an incentive for us to continue operating out of that site. If it's become a secondary site as a result of us securing a better site, then there's far less likelihood that we would continue on with it.

MR O'DONOVAN: Yes, but there is still certain – there are still cases where you will continue with the lease to block a competitor entering that local market?

MR BOYCE: Blocking a competitor would not be the prime motivation. The motivation would be to continue making money and sales and satisfying our Coles customers.

MR O'DONOVAN: So you're saying that there are no stores which you – which, on their own, wouldn't justify remaining open just in terms of their return, the return that they're giving the company, that are kept open for the purpose of blocking competitive entry?

MR BOYCE: We've got a lot of stores that we'd like to make a lot more money out of. We can talk to you again in camera about some of the decisions that we're intending to take around those.

MR O'DONOVAN: All right.

MR BOYCE: So that's probably best dealt with - - -

MR O'DONOVAN: Okay, but would it be fair to say that there are some sites where at least part of the motivation for keeping them or occupying them is to prevent competitive entry into that local market as a challenge to Coles?

MR BOYCE: I think by virtue of the fact that we remain in those locations you could argue that that's stopping somebody else from getting into that location.

MR McMAHON: But our primary objective is – I just want to reinforce what Tim said. Our primary objective is the networking to make money, and in camera we'll take you through how we treat some of the stores that don't make money if we don't think that they can do so in the future.

MR O'DONOVAN: All right. Well, then in terms of your options as a retail group, it's possible to change a store into another part of the retail group so – introduce a First Choice Liquor or a Target as an alternative. Do you ever do that for the purposes of blocking – for I suppose market protection or protecting the supermarket market that you have?

MR BOYCE: I think what's important is that we do have Target and First Choice and other businesses, and if we put those – you know, and if there's a good location to put those businesses, then that's our prime motivation. So prime motivation is to secure rare retail sites for whichever one of our businesses we can secure them.

MR McMAHON: So we don't do it for blocking reasons, and I can assure you that the people running those other businesses are very keen that they go into the right locations and they make the appropriate returns.

MR BOYCE: It's also worth understanding that our leases have permitted use clauses in them, and so we don't have an as of right ability to turn a supermarket into a liquor store or a Target store without negotiating that with the landlord. If the landlord doesn't want that, then we can't simply put a Target store or a liquor store into those locations.

MR O'DONOVAN: Okay. Now, in relation to sites that are suitable for petrol stations, Woolworths gave evidence that they would often, or more recently have been asking landlords for the right of first refusal when entering into a lease for a supermarket; they would ask for a right of first refusal if there was a site that might become available for a petrol site. Is that any part of Coles' practice in terms of negotiating its leases?

MR BOYCE: It's not a standard part of our practice, and I'll explain why in a minute, but we do ask for that on occasions. Predominantly because of the way that we operate our Coles Express business, there is a benefit to our customers from using their fuel dockets. The reason why we don't always have – or we don't always ask for a first right of refusal is there is a significant network of Coles Express Shell service stations out there, in a lot of cases will already satisfy the requirement of that supermarket in terms of having a petrol station like, you know, in the primary trade area of that supermarket in which case we don't need a first right of refusal.

The other thing is it is actually Shell's responsibility to secure those sites, so they act as the head lessor of all of those locations. So in a number of cases if we don't necessarily think that it's a location that they would want to tenant or occupy, because they can't get the appropriate fuel volumes, we won't ask for a right of first refusal.

MR O'DONOVAN: Okay. So in the last 12 months, how often would you have asked for a right of first refusal?

MR BOYCE: I honestly couldn't tell you.

MR O'DONOVAN: Would it be five, would it a hundred?

MR BOYCE: It would be less than half of our supermarket deals.

MR O'DONOVAN: Right, but more than 30 per cent?

MR BOYCE: There's a difference between how often we might ask and what we might actually get.

MR O'DONOVAN: Okay, but in terms of how often you would ask?

MR BOYCE: I'd say probably less than 50 per cent.

MR McMAHON: We can check for you, at least in terms of how many we've got. I don't know where we can check how many we asked for.

MR O'DONOVAN: Okay.

MR BOYCE: Yes, we can.

MR O'DONOVAN: That's all I had on sites. Does anyone have any - - -

COMMISSIONER KING: Just one thing if I can, Mr Boyce, can I take you back to Chermside which is in Brisbane. Now, Chermside is a pretty big shopping centre, from memory.

MR BOYCE: It is, yes.

COMMISSIONER KING: In fact, I think it's the biggest shopping centre in Brisbane?

MR BOYCE: I couldn't tell you on gross lettable area, but if it's not it's pretty close.

COMMISSIONER KING: Yes, it's a pretty massive store. It would have a pretty big catchment area I would have thought.

MR BOYCE: A big catchment area with a lot of supermarkets within that catchment area.

COMMISSIONER KING: So when you said that Chermside couldn't support three supermarkets, what was the basis – I mean, what sort of analysis did Coles go through to enable you to make that statement?

MR BOYCE: Well, we know the sales that we make out of the stores that were there, and we take a guess at what we think, you know, a Woolworths store would be doing there. But one of the most – sales is one element. The other element is convenience, and it's a big road network around Chermside. And in terms of what the Coles customer is interested in, convenience of parking is a key element. I'm sure that's the same for Woolworths and other supermarket businesses. And Chermside, from the perspective of the supermarket shopper, just wasn't as convenient as some of the neighbourhood centres that surrounded that area.

COMMISSIONER KING: So on Coles basis, Coles decided that that supermarket – or, sorry, that shopping centre couldn't support three supermarkets. Isn't that a decision that is better left up to the landlord? I mean, the landlord tenancy agreements are based on a share of revenue, so isn't it a better thing for the landlord to say, well, we actually think this would be more profitable with three supermarkets?

MR BOYCE: I think I can assure you that if Westfield really wanted it to have three supermarkets, three full range supermarkets, it would have had three full range supermarkets.

COMMISSIONER KING: So even though Coles only gave up a BI-LO lease on the condition that there wouldn't be three supermarkets, are you saying Westfield would have simply ignored that condition or - - -

MR BOYCE: We might talk in camera about the basis on which we had that negotiation because it was done in the context of a broader group negotiation I suppose.

MR McMAHON: So I think if we could add these things are never one dimensional. So there is always a trade off between lease surrender payments and the like and Tim can take you through some of them later.

COMMISSIONER KING: All right. I mean, just judging by the size of Chermside, and I am trying to think from my own experiences, I think the only bigger shopping centre I have come across is Chadstone here in Melbourne. I am sure there are other larger ones I haven't been to but Chermside can't support three supermarkets. How many shopping centres around Australia would Coles consider could support three separate, independent, full line supermarkets?

MR BOYCE: I think, simply put, the answer to that is not many.

COMMISSIONER KING: Any?

MR BOYCE: There will be some.

MR McMAHON: We should say, can I just add, just put some context in this, that it is not our policy to have two supermarkets in the one location. I think I am right in saying that the only ones we have are as a result of previously having a BI-LO brand and a Coles brand. But we are seeking to extricate ourselves from those where we have a double up. We still have a small number, a very small number, where we have not yet negotiated our way out of a lease but it is not our policy to have two in one location.

COMMISSIONER KING: No, understood. They needn't be Coles and BI-LO or two Coles supermarkets and a Woolworths. I am just wondering – it was Coles' analysis as I understand your evidence, Mr Boyce, Chermside couldn't support three independent full line supermarkets. So, for example, a Coles, a Woolworth and a Super IGA.

MR McMAHON: Well, I think Tim is offering an opinion based on 17 odd years experience but ultimately that's a Westfield call in that location.

COMMISSIONER KING: Although it was part of a lease surrender - - -

MR McMAHON: Sure, sorry.

COMMISSIONER KING: - - - highlighted. So it wasn't - - -

MR McMAHON: Yes.

COMMISSIONER KING: - - - Westfield's choice. It was actually Coles' choice.

MR McMAHON: Well, coming back to Tim's point - - -

MR BOYCE: I think we are talking about whether it was Coles' choice or - - -

MR McMAHON: Yes. We will take you through the logic.

MR BOYCE: - - - or Westfield's choice.

COMMISSIONER KING: Okay. Can I, then, just come back to my last question which is, you know, if Chermside can't support three full line supermarkets which shopping centres in Australia, in Coles' opinion, can support more than just a Coles and a Woolworths or a Coles and one other like a Super IGA? Are there any shopping centres in Australia that in Coles' opinion can support, commercially, a Woolworths, a Coles and one other full line, not an ALDI, but a full line supermarket?

MR BOYCE: I think, off the top of my head, there would be examples in Victoria like at Eastland, for example, where if a further stage was entered into and the car parking was appropriately convenient then there are opportunities but evidence over the last 20 years of having three successful full line supermarkets in shopping centres in the Australian market suggests that there are very few where three full line supermarkets operate happily and successfully and profitably for each one of those businesses in the long term and we have to keep reflecting on the fact that when we enter into a new lease we are intending to be there, probably, for 50 years and so in terms of the long term that is very rare in the Australian market place.

MR O'DONOVAN: So, I mean the consequence of your last answer to Dr King's question is that there won't be opportunities for a third independent player in most sites.

MR BOYCE: No, I am not suggesting that at all. So in individual shopping centres it depends on the location you are in and so if you are in the best location in terms of customer access, road network, then it probably doesn't matter which business you are. The best location in large shopping centres is the most convenient for customers and so one of the very significant consideration sets along with, as Nick and the others have pointed out, the value, the range, the service, and so if you have got the best independent site in a shopping centre then you are likely to make the most money.

MR O'DONOVAN: Sure. But in circumstances where it is the practice of landlords to approach Coles and Woollies as a priority to be anchor tenants and there are no shopping centres, or perhaps only one or two that can sustain a third supermarket, the possibility of an independent supermarket securing a site, the best site, in a shopping centre is pretty remote in its current environment.

MR McMAHON: I come back to an answer I gave this morning which is to say that if a strong brand with a strong offer and a strong supply chain was there I am sure the shopping centre landlords would, very quickly, adapt to having that offer in their shopping centres. But it comes back, also, to the scale point I have made which is that to operate successfully to deliver low prices and value to customers there is some significant scale required to deliver that nationally.

MR O'DONOVAN: Right. But in terms of what we understand, at least, of landlord behaviour at present is that they don’t, notwithstanding that there are large format independent supermarkets which are price competitive and operate strongly and compete strongly against you in pockets, landlords don’t offer those things. They don’t offer suitable sites to independent supermarkets.

MR McMAHON: Well, I think you would have to ask them that but as I said earlier this morning I think they would prefer a Coles or a Woolworths certainly.

MR O'DONOVAN: So, and that being the case if we have got that as a given, if there are not shopping centre sites that can be, in your assessment, can accommodate the third supermarket we are not going to see a change to the structure of large format supermarkets in this country if that is the current attitude of landlords.

MR McMAHON: I guess I can’t guess the attitude of landlords but can I say something to, perhaps, frame this up a little bit from our perspective which is that we believe that some of these clauses that you are referring to are the outcome of the whole set of commercial discussions and take you through some of the detail of that. But if it was to be the case that the restrictive clauses were constrained in time or in their nature we think the rest of the commercial discussion would adapt to that. So we are open to that and we think that what you have got is just a set of circumstances and our only concern would be if you looked at it as a one dimensional issue and just to give you a feel we have base rents which tend to only go one way.

In other words they, if you are making an investment for 20 years and rents can only go one way, if a new supermarket opens up you lose 50 per cent of your sales say, in this example, and your rent is still here that is a big problem and we couldn’t then invest with certainty, the landlords couldn’t invest with certainty, and ultimately customers wouldn’t get the sites they wanted. But if there were commercial circumstances which adapted to the fact that there were constraints around some of those clauses we would be quite happy going forward. It will just change the nature of our discussion with the landlords.

MR O'DONOVAN: Perhaps this might be best left for the confidential session but certainly that concern about escalating rents or commercial viability of a site would not be present when you are surrendering a lease and yet you ask for a restrictive current covenant. Is that – would you agree with that?

MR McMAHON: I think we had better let Tim take you through a few examples because sometimes surrendering a lease involves some very significant payments and, again, you can't look at it as one dimensional because some of those payments vary depending on the particular clauses that you negotiate with the landlord. We will take you through some examples but, again, we can't disclose it in public because of the other side of the equation.

MR O'DONOVAN: Right. All right. Well, then moving on to your trading terms and the terms and conditions on which you acquire fresh produce in particular. It is behind tab 18 and it is clause 5.4 in particular that I am going to talk to you about.

MR McMAHON: Yes.

MR O'DONOVAN: Okay.

MR McMAHON: Can I just ask David to have a look at that first and then - - -

MR STEVENS: Yes. Okay.

MR O'DONOVAN: Okay. Now, what clause 5.4 provides is that:

> *Coles may reject any goods delivered which are not in accordance with the order and these conditions and will not be deemed to have accepted any goods until the purchaser has had a reasonable time to inspect them following delivery within a reasonably time after any latent defect in the goods has become apparent.*

MR STEVENS: Yes.

MR O'DONOVAN: Now, that's the standard basis on which you buy fresh fruit and veg?

MR STEVENS: Yes.

MR O'DONOVAN: Now, as I understand it Coles does a lot of buying through wholesaler growers or consolidators so effectively not all of its dealings are direct with growers. Is that right?

MR STEVENS: The majority of its dealings are direct with growers. We do buy a portion off the wholesale market.

MR O'DONOVAN: But when you say you are dealing with the grower are there growers, that you are aware of, that in addition to growing a proportion of what they supply to Coles also acquire from third party growers which they then assemble - - -

MR STEVENS: Yes.

MR O'DONOVAN: - - - and then sell to Coles?

MR STEVENS: That's right. We do have lead packers or lead growers and aggregated product that would deliver directly to us from a growing region.

MR O'DONOVAN: And what proportion of your fresh produce would come through an arrangement like that?

MR STEVENS: 80 per cent would come through relationships of that nature.

MR O'DONOVAN: So it is in fact the substantial majority of what you buy comes through.

MR STEVENS: Be either direct or through aggregation of direct growers.

MR O'DONOVAN: So just to track the product from the field. When the growers, the smaller growers who don't have a direct arrangement with you, once they have prepared their crop they then deliver it to an aggregator who has the arrangement, who has the relationship, with Coles. Is that right?

MR STEVENS: Yes. They would be our supplier of goods. Correct.

MR O'DONOVAN: So at that point in time the grower loses control of the product.

MR STEVENS: The grower - - -

MR O'DONOVAN: And it goes - - -

MR STEVENS: The grower meets the supplier's needs, who is the aggregator, who is composing a sum of an order from the approved growers.

MR O'DONOVAN: So then from the grower's point of view they leave it with the aggregator.

MR STEVENS: Yes.

MR O'DONOVAN: And that's the last they see of the goods.

MR STEVENS: Yes, they hand over at that point. That's right.

MR O'DONOVAN: And there is a direct relationship between the aggregator and the grower but Coles has no direct relationship with the grower in that case?

MR STEVENS: In that case, no.

MR O'DONOVAN: So then the goods are aggregated for the Coles order and the aggregator then has responsibility for delivering it to Coles.

MR STEVENS: Yes.

MR O'DONOVAN: Now, I understand, and please let me know whether you are happy to talk about time frames in public, but I understand that then it can be delivered to a Coles delivery centre and it can either be accepted or rejected at that point.

MR STEVENS: In regard to?

MR O'DONOVAN: The quality.

MR STEVENS: The quality?

MR O'DONOVAN: Yes.

MR STEVENS: Yes. So we receive the goods and then there is a 48 hour window which we can determine whether the product is meeting specification and that window allows for product to come out of quite prescriptive temperature conditions to more normalised store trading conditions at which point you see the true quality of the goods. So that 48 hour window is the point at which we can advise the supplier of a rejection.

MR O'DONOVAN: So in terms of what Coles regards as a reasonable time for inspection of the goods and identification of any latent defect - - -

MR STEVENS: Yes.

MR O'DONOVAN: - - - it is 48 hours after it comes into Coles possession?

MR STEVENS: Yes.

MR McMAHON: We should just clarify though, I think, that that’s at the outside. If it is obviously not up to standard it doesn’t take 48 hours but that’s the time window we give.

MR STEVENS: Yes. More typically it would be 24 hours as it has arrived in the DC and that would be most typical because you would, on arrival, enter the DC, understand the quality dimension specification but there are instances where the nature of the quality doesn’t come through until it has actually reached the store.

MR O'DONOVAN: And gone straight to the store?

MR STEVENS: Yes. And that would be the 48 hour position but as Nick has suggested typically the first 24 hours is where the main quality rejection would take place.

MR O'DONOVAN: So looking at it from the grower's perspective it has left their hands with the aggregator and that the aggregator may have had it for one or – so as when the aggregator took it. The aggregator said they have their own quality procedure don't they; the aggregators?

MR STEVENS: Yes. The aggregators would represent the specification that we have agreed.

MR O'DONOVAN: Yes. Okay. So the aggregator says it is okay. Then it is shipped to a DC and in another 24 hours and the distribution centre says it is okay and then it is shipped to the store at which point the store may say it is not okay we are going to reject the goods.

MR STEVENS: Yes, there are some cases where that happens.

MR O'DONOVAN: Yes. All right. Now, at that point in time it has been in Coles possession for more than 48 hours?

MR STEVENS: No.

MR O'DONOVAN: Well, it can have been up to 48 hours.

MR STEVENS: Up to 48 hours, yes.

MR O'DONOVAN: At which point it is quite possible that the reason the goods are not up to a standard appropriate for sale is because of how they have been handled or dealt with by Coles. That's right isn't it?

MR STEVENS: No, I think we – I mean, the context is we don't have many rejections but when we do we treat them very seriously by way of communication to the grower. So there is an advice notice that goes with pictures of the product, the reason for the rejection. So it is something we treat very importantly because the growers are the most important part of our business and if they are not being treated fairly then they will make other decisions about who they do business with. So there is a small amount of rejections. Most of them happen in the first 24 hours with very good advice going back to the grower.

A small amount of quality rejections don't manifest themselves until they have reached the store. Typically products that have come from a cool chain to an ambient condition and quality defects do become more evident in that second 24 hours. But it is still a small portion of our total receive.

MR O'DONOVAN: But in terms of what is possible it is possible that goods will have been with Coles for almost 48 hours and in fact away from the grower for even a much longer period than that and Coles, at that point, will try – will make a judgment and decide to reject the goods? That's a matter of fact. That is possible.

MR STEVENS: Yes. That is possible.

MR O'DONOVAN: And at that point it may not be possible to work out whether the goods have deteriorated because of Coles' handling of them or because of the condition in which they left the grower? That's possible isn't it?

MR STEVENS: Well, it is, however, I must add that we take small amounts of store determined quality issues and wear the cost ourselves.

MR O'DONOVAN: Yes.

MR STEVENS: We only make decisions to reject in store where there is a consistent and high quantity of advice from stores that says there is something wrong with this product. So the small amounts which I probably put down to, perhaps, some handling issues and not material amounts of defect we just wear the cost and accept that that's part of the cost of doing business. We will advise where there is a material and large scale feedback that says there is something wrong with this.

MR O'DONOVAN: Yes. But in some ways that's worse in that if you are rejecting a large amount of produce that is going to have a much worse impact on the grower and you are still no closer to working out whether it is because of Coles mishandling of the goods or whether it is caused by the aggregator's mishandling of the goods or the growers mishandling of the goods. Would you agree with that?

MR STEVENS: Well, I think it is probably worse for our customer actually which means that - I think you are referring to the grower and ourselves as having a different interest and we have exactly the same interest. So it is bad news for our customer who doesn't get the right product. It is bad news for both ourselves and the grower because we haven't made money on a particular consignment of goods.

MR O'DONOVAN: Yes. But it is even worse for the grower because Coles is not going to pay the grower for those goods. It is not going to – well, let's start with the relationship Coles has with the aggregator. When Coles sends it all back Coles doesn't pay for those goods?

MR STEVENS: No. That's right.

MR O'DONOVAN: So in a sense Coles is out of the players in the chain, at this stage, better off than the consolidator because the consolidator is not going to get paid for the goods which it has just supplied?

MR STEVENS: Well, better off than the dimensional cost of goods. But Coles is pretty poorly off in terms of availability of wanted items for customers and that's pretty bad news for Coles. So there is, kind of a - - -

MR O'DONOVAN: Everyone has incentives to - - -

MR STEVENS: It depends which dimension you are looking at. From a Coles' dimension it is equally bad news but, perhaps, in a different dimension.

MR O'DONOVAN: Yes, look, everyone in the chain has an incentive to get food to the customer in good order. I wouldn't dispute that. But when you have a problem and you have a big problem as in you have got a big order which is going to be rejected and it has been in Coles' possession for more than 24 hours - - -

MR STEVENS: Yes.

MR O'DONOVAN: - - - the loss, notwithstanding that it could have happened while it was in Coles' custody, the deterioration, the loss will be sheeted back to the grower consolidator which Coles has the relationship with under your current terms?

MR McMAHON: I think it is worth just coming in because there is an assumption - - -

MR O'DONOVAN: No, no. Can I just get an answer to that question?

MR STEVENS: So?

MR O'DONOVAN: So in circumstances where Coles rejects the goods - - -

MR STEVENS: Yes.

MR O'DONOVAN: - - - the loss falls on the aggregator grower?

MR STEVENS: Where Coles rejects the goods when it is of a material amount, yes, it does.

MR McMAHON: And if I could just add and where we conclusively demonstrate through a detailed process including photos of product that it in fact was a problem at source and not a problem in our handling. So you shouldn't assume that that's a one way street. There is quite a bit of give and take around that process.

MR O'DONOVAN: All right. Well, I understand that you can demonstrate that there is a problem with the goods. The question is can you demonstrate that the problem is not with how Coles handled them and that's - - -

MR McMAHON: Well, I believe we can. That's the process that David described. I don't know if you want to add to that, David, but photos and so on.

MR STEVENS: So we are confident that the handling of goods from our DC to our store is robust enough that it would be unusual for that, in that window, for it to have been Coles' issue that a product has failed to meet its specification on day two of entry to Coles Supermarkets. Very unusual.

MR McMAHON: And if it happens we wear the cost.

MR O'DONOVAN: Well, I don’t think you do. As I understand it goods which have passed specification at your consolidator aggregators point and have again passed inspection at the point of your delivery centre and are then rejected at the Coles store level, if it is a large order, the cost is worn by the – is pushed back down the chain by Coles back to the consolidator aggregator?

MR STEVENS: Yes, that’s right.

MR O'DONOVAN: That’s correct. All right. Now, you would understand that the – are you aware of the terms of the horticulture code which I know does not apply to Coles?

MR STEVENS: Yes, I am.

MR O'DONOVAN: All right. Now, you are aware that in its current form you are required to specify at the point at which goods are delivered the time in which rejection is permissible?

MR STEVENS: Yes.

MR O'DONOVAN: Okay. And at present, well, you say there is this less than 48 hour period. That’s not currently specified in your terms of trade?

MR STEVENS: Right. Okay. I accept that.

MR O'DONOVAN: So the question I had is if you were required to comply with the code would the effect be that you would specify a shorter time or would you simply specify to your growers at the point of delivery or to aggregators the point of delivery that you will have up to 48 hours to reject the goods?

MR STEVENS: I suppose we believe, based on the Produce and Grocery Code, that our transparency of trading terms is pretty open. We think we have got some areas of improvement but I suggest within the 48 hour principle that we currently adopt is a fair assessment of when quality can be best advised from the customer point of view. So I guess that would be subject to further discussion as to how that might go about if you looked at the codes but from our point of view we have introduced that 48 hours because we think that’s the most rational understanding of what a customer sees as the final point of decision making.

MR O'DONOVAN: Okay. So based on at least your current practice and your current view of the 48 hours, it’s likely that the horticulture code might result in a change in your precise terms of supply but probably not your actual practice in terms of - - -

MR STEVENS: For my personal view I would suggest that’s a rational and sensible way of verifying quality but clearly that will be subject to further discussion around the code and how that might manifest itself.

MR O'DONOVAN: All right. Now, in terms of once there has been a rejection and it’s put back to the company you have the relationship with which is the aggregator of the produce.

MR STEVENS: Or the direct grower in cases.

MR O'DONOVAN: If we can just deal with cases where that person is aggregating someone.

MR STEVENS: Okay.

MR O'DONOVAN: Another growers produce. Under the horticulture code they’re obliged to have taken property in the goods and risk. Are you aware of that?

MR STEVENS: Yes, as a first receiver of the goods.

MR O'DONOVAN: Okay. So if they are complying with the horticulture code, the consequence is that all of the loss of rejected goods would fall in them.

MR STEVENS: Right. Okay.

MR O'DONOVAN: Is that your understanding.

MR STEVENS: Yes. Sorry, I’m not as familiar with all the dimensions of the code but, yes, as a receiver of the goods they have owned the goods effectively.

MR O'DONOVAN: Yes. Okay. Now, does Coles ever monitor whether or not they subsequently require growers to take the goods back or not pay growers for the goods in circumstances that they would not – they would not be complying with the code?

MR STEVENS: Not that I’m aware of. I’m not familiar with that.

MR O'DONOVAN: Okay. So does Coles do any monitoring of the people who operate – I won’t say on Coles’ behalf but who are effectively engaged by Coles to deal with growers. Does Coles monitor their behaviour or monitor the extent to which they comply with the horticulture code?

MR STEVENS: I don't know of any formal monitoring. Certainly informally with the – as a buying team visiting growing regions and growers and picking up feedback informally but I don’t have any formal monitoring that we undertake.

MR O'DONOVAN: Okay. And do you ever have complaints from growers that they are being forced to carry the consequences of rejection even in circumstances where they sold the goods to a consolidator?

MR STEVENS: I haven't been aware of any. Certainly in the last year or so I haven't been made aware of any.

MR O'DONOVAN: Right. Have you been made aware of any at any time?

MR STEVENS: No. At no time have I been made aware of any.

MR O'DONOVAN: Okay. And have there been circumstances were you have been talking to the smaller growers where they could have had an opportunity to make a complaint to you?

MR STEVENS: Yes. I have spoken to a number of growers and visit farms reasonably regularly and I guess the informal side is provide the opportunity to listen to what's going on and there haven't been any that have been made aware to me.

MR O'DONOVAN: Okay. Now, when you say you visit growers are you talking about growers with whom Coles has a direct relationship with?

MR STEVENS: A mixture.

MR O'DONOVAN: A mixture. So including growers that Coles - - -

MR STEVENS: Yes.

MR O'DONOVAN: - - - does not have a direct relationship with.

MR STEVENS: Yes.

MR O'DONOVAN: So just to confirm, so it's never been – you've never been advised of growers being effectively requested or required to accept the losses as a consequence of a rejection of Coles notwithstanding that Coles wasn't dealing with that grower, it was dealing with an intermediary?

MR STEVENS: Sorry. I have never been advised? I've lost the question.

MR O'DONOVAN: It was a bad question. Can you confirm you have not been advised? But you have had no complaints from a grower that they have been required to wear the consequences of a rejection even though that grower didn't have any direct dealings with Coles and had sold its goods to Coles consolidator.

MR STEVENS: I can confirm that. I have had no feedback of that nature.

MR O'DONOVAN: Okay. That was all I had on terms of trade.

THE CHAIRMAN: All right.

COMMISSIONER MARTIN: Well, just on – I think, Mr McMahon, you made the comment in relation to – you said you wouldn't want two codes to apply but you would feel fairly relaxed about a single code. Did that include if it was a mandatory code?

MR McMAHON: Yes. Obviously we would like to work, as David has said, to work through the produce and grocery industry code and the horticulture code and be involved in that in some way and to make sure that what we came up with as one code was workable and effective. But we do believe that there is the opportunity for better transparency. We believe that our dealings direct with growers and our dealings with agents are exactly what you would expect them to be. But I am aware although, as David says, I don't get direct complaints but there is certainly a lot of industry noise about dealings between agents – aggregators and growers.

COMMISSIONER MARTIN: In that there is confusion?

MR McMAHON: Well, there is at least the room for commercial uncertainty for the grower. I'd say that much and we have done two things in that regard and we can take it through the detail in camera but one of them is that rather than have some of our aggregators responsible for quality control so we intend to take that quality control on board ourselves so there is one standard rather than our standard and the aggregator's standard, so we remove uncertainty for the grower; and the second one is that - and this is where I can't comment on specifics in public, but we will pay the grower direct. So in other words then the aggregator becomes more a fee for service, a service provider rather than a commercial agent in the middle and we would like to go down that path and we think that lends itself also to one code.

COMMISSIONER MARTIN: And there also seems to be a balancing act from the grower's side that they don't have too many – too high a demand in terms of satisfying certification standards. There are costs there but at the same time - - -

MR McMAHON: Because we are very conscious and I would stress that 48 hours is the outside but we understand the point behind your questions but that can be a long time for a grower who then has to try to find an alternative source of that product and we understand that.

MR O'DONOVAN: Could we take a break for 10 minutes?

THE CHAIRMAN: Yes. Now, how many more topics have you got to do in public?

MR O'DONOVAN: One plus one question. So, yes, one major topic then one just general question.

THE CHAIRMAN: And how long will that take?

MR O'DONOVAN: You know what I'm like with estimates.

THE CHAIRMAN: Yes.

MR O'DONOVAN: Look, I think half an hour.

THE CHAIRMAN: That one topic that is left in public?

MR O'DONOVAN: Hopefully only half – hopefully less but half an hour.

THE CHAIRMAN: Yes. Okay. Well, we had better take a break then I think and then we will do that and then you've got some - - -

COMMISSIONER MARTIN: 10 minutes.

THE CHAIRMAN: Yes. We will take a 10 minute break.

ADJOURNED **[3.30 pm]**

RESUMED **[3.43 pm]**

THE CHAIRMAN: All right. Well, we seem to have thinned out the room of observers. We'll probably get the most interesting part now, Mr O'Donovan, so over to you.

MR O'DONOVAN: Okay. Well, keeping on the theme of fruit and veg, just in terms of understanding how prices are agreed in relation to fresh produce, our understanding is that Coles attempts to agree rough volumes in prices a week in advance, that there is no firm price until just prior to despatch. Are we correct in our understanding?

MR STEVENS: Yes. On the – typically on the Wednesday prior to the Sunday to Saturday trading week we would agree I guess indicative volumes and prices which in the vast majority would be the actual end, volume and prices.

MR O'DONOVAN: And our understanding is that there is a relationship between what Coles pays and the wholesale market but it can vary to a fair degree from what is happening in the wholesale markets. Is that right?

MR STEVENS: I think it would probably be always monitored against the market in total, with a view to being competitive. So there would be – there would always be quite a link to what is happening in the wholesale market in Coles prices.

MR O'DONOVAN: Now, do you personally look at the published Aus market data about what is going on in the wholesale markets?

MR STEVENS: I personally don’t, no.

MR O'DONOVAN: Do you know if your buyers do?

MR STEVENS: I would know that my buyers are familiar with the wholesale pricing in the market as, of course, is their job on a week to week basis. Yes.

MR O'DONOVAN: But do they do that by specific market intelligence or do they by the Aus market reports? How do they obtain information about the wholesale market?

MR STEVENS: It’s mostly through our State teams. We have State buying teams who would be the market intelligence on their behalf.

MR O'DONOVAN: Right. And they obtain it just by actually buying within the wholesale markets?

MR STEVENS: Being familiar with people in the wholesale market and prices are each day, yes.

MR O'DONOVAN: And do they do – and is a proportion of Coles buying actually done in the wholesale markets?

MR STEVENS: Yes, it is.

MR O'DONOVAN: And roughly what proportion?

MR STEVENS: About 20 per cent.

MR O'DONOVAN: And is that done by Coles direct or is that done by some providor or consolidator on behalf of Coles?

MR STEVENS: Coles direct through our State buying teams.

MR O'DONOVAN: So you have got employees who actually go out early in the morning.

MR STEVENS: That's right.

MR O'DONOVAN: And negotiate prices direct with wholesalers.

MR STEVENS: Yes.

MR O'DONOVAN: Do you internally keep any data about the relationship between the price that you pay direct to growers and the prices that you are able to obtain when you deal direct in the market?

MR STEVENS: Well, we certainly record all transactions because it's all invoice based. In terms of the relativity I guess, because we record them, we've got them so by nature we have access to the pricing relativity in that regard.

MR O'DONOVAN: Right. But it's not something that is reported to you or that you regularly acquire a report?

MR STEVENS: Not something that I would get regularly, no, or if at all actually.

MR O'DONOVAN: Okay. Now, if in terms of when you decide to run a special that where a particular fruit or vegetable will appear in a catalogue?

MR STEVENS: Yes.

MR O'DONOVAN: Is that initiated at the Coles end of things or is that initiated at the grower end of things?

MR STEVENS: It would be either/or and generally you would be planning with your grower base for points in the season when it would be most appropriate to special typically when there's just crop coming through in large quantity.

MR O'DONOVAN: So in relation to a special that the price and volume – indicative price and indicative volume will generally be agreed on that Wednesday prior to - - -

MR STEVENS: Yes. The same principle would exist for a special as any other product and price.

MR O'DONOVAN: And then the catalogue is released on a Sunday or a Monday?

MR STEVENS: Yes. Customers get them on the Sunday, Monday.

MR O'DONOVAN: And that will factor in the price that was agreed on the previous Wednesday?

MR STEVENS: Yes. That's right.

MR O'DONOVAN: Now, in circumstances where Woolworths also releases a catalogue and also specials the same product.

MR STEVENS: Yes.

MR O'DONOVAN: And especially at a lower price, what is Coles' competitive reaction in those circumstances?

MR STEVENS: Most typically we would match the Woolworths price or the competitor price that we deem virtually erodes our competitiveness and customer trust in our values. So we would typically match in the market place.

MR O'DONOVAN: And at that point in terms of from a grower's perspective it would appear to create conditions where there is going to be a lot of demand for their product because both Coles and Woolworths are specialling at the same time so it actually might lead to quite tight market conditions where they can extract a good price that week. Normally what could happen - - -

MR STEVENS: I suppose the supposition is that any promotion has been organised to be communicated through a catalogue would be well organised, known, volume coming from supply. So the tightness that you refer to would be perhaps down to poor planning but should be – there should be sufficient volume to satisfy that kind of commitment to the customer in the catalogue.

MR O'DONOVAN: But in terms of price you agree that a price – you have indicated that a price adjustment needs to be made at the retail level to ensure that you remain looking competitive?

MR STEVENS: Yes. Typically in this practice and that by Monday morning such – it's quite specific that by Monday morning by 9 o'clock any advice and negotiation should have taken place to effect the small number but important number of changes that may be required and it's also upward as well as downward so it's just, yes, it's important to recognise the markets can tighten over the course of the weekend which means that the growers having the conversation with us around, it would be in their interest to ease the price to ensure availability, so it is up as well as down.

MR O'DONOVAN: So in circumstances, but in looking at it exclusively from Coles' point of view the competitive reaction that's required when Woolworths is cataloguing the same product at a lower price is that Coles is going to have to match at the retail level to demonstrate its value.

MR STEVENS: Yes, typically, not for every item but where we think it's going to make an impact on our competitiveness, yes.

MR O'DONOVAN: Now, once the decision has been made to drop a price at the retail level does Coles then go back and seek to renegotiate the indicative price that was confirmed the previous Wednesday?

MR STEVENS: Yes. That's right.

MR O'DONOVAN: And in those circumstances it asks the grower to lower their price?

MR STEVENS: Yes.

MR O'DONOVAN: To help you meet the competition?

MR STEVENS: We do. We outline the change we would like to make and enter into a negotiation to effect the change and I guess we would recognise that again it’s in both our interest to move through a quantity of goods because clearly neither us or a grower wants to be left with a lot of goods on show that affects deliveries for the following week. So it would be that style of negotiation and discussion.

MR O'DONOVAN: And at that point is it fair to say that Coles is willing to put some pressure on its growers to encourage them to assist Coles in meeting its retail price objective?

MR STEVENS: Well, I guess pressure suggests it’s a bit of a one way street. I suggest that we would discuss what change we would like to make on a Monday morning and for that small number of items would seek to come to a fair conclusion for both parties. That would be the intention on the Monday morning.

MR O'DONOVAN: And would it be fair to say that a small grower dealing with a very large consumer of its product, probably its single largest customer, Coles has a fair bit of leverage in getting them to adjust its price to suit the competitive condition that Coles has to face?

MR STEVENS: In a pure short term big buyer, small grower, yes. In the reality we don’t have relationships for 10 or 15 years without having trust and openness in our relationships. So in reality it wouldn’t be in our interest to have a grower base that wasn’t feeling that Coles were being fair in their transactions.

MR O'DONOVAN: So if a grower simply says to Coles: look, I’m not willing to participate, I’m not willing to drop my price, is there a risk that the grower will be given a holiday or they will be less attractive, that they will receive less orders for the next few weeks from Coles?

MR STEVENS: I guess that would be a risk. Yes.

MR O'DONOVAN: And that does happen?

MR STEVENS: Specific to a promotion or a reduction?

MR O'DONOVAN: In any circumstances where Coles is seeking to extract a concession from a grower?

MR STEVENS: I don't know of an instance where it has happened a supplier has stopped supplying. I don't know of an example. I would imagine at some points that has happened, yes.

MR O'DONOVAN: No, no. Perhaps you misunderstood the question. The question I asked was: are there circumstances where the grower in the short term says, I don't want to contribute at that price. I don't want to put volume through at that price. I don't want to give you a discount, and the consequences being that Coles as punishment has stopped buying for a period of a few weeks or one of Coles aggregators stops buying for a few weeks to punish the grower for not being more compliant with Coles' requirements?

MR STEVENS: Sorry. So is on a – so there's a weekly buying cycle. Is it referring to the weekly buying cycle which is effectively a tender, partly a tender process? So in that respect on a Wednesday, for example, when we collect prices from the group of suppliers who we can do business with, we would be making decisions then as to sharer volume based on competitiveness of prices.

MR O'DONOVAN: No, no. After that process is complete then you find yourself in a position where you need to get a keener price on a product.

MR STEVENS: On a Monday morning?

MR O'DONOVAN: Yes. On the Monday morning.

MR STEVENS: Yes.

MR O'DONOVAN: And an approach is made to a grower to participate by lowering the indicative price.

MR STEVENS: Yes.

MR O'DONOVAN: In order to facilitate Coles matching Woolworths' price. Okay? This is a Monday morning discussion. The grower says: no, I don't want to participate in that. I'm not going to give you the price that you're asking for; and the question is, at the next Wednesday - - -

MR STEVENS: Yes.

MR O'DONOVAN: - - - when decisions are made about who to obtain volume from.

MR STEVENS: Yes.

MR O'DONOVAN: Is the grower, in refusing to lower their price, taking a risk that they will not have any volume taken by Coles or one of Coles' consolidators because of that refusal?

MR STEVENS: I would hope not and I have no evidence to suggest that.

MR McMAHON: Perhaps, if it’s not in David’s experience can I just – Cameron ran Fresh before David. Cameron, were you aware of any such incident?

MR TRAINOR: Look, it wouldn’t be in our interest to – I think your terminology was holiday, because if somebody is a small supplier and for us to be doing business with them there has got to be a commercial reason why we want to do business with them. Coles has moved away from the central market system over a number of years and we have got approximately 80 to 85 per cent of our produce coming through either a direct or an aggregator arrangement. By the sheer definition of us being away from the central market system for such a large part of our volume, we need our suppliers because for us to stop purchasing off somebody next week means that we’re going to probably have experience in store that is going to be bad for customers because we’re going to be at a shorter product, we’re not going to have the right quality product for customers.

So to your question, has it ever, ever happened? Certainly of my time I can't recall in the two years that I led Fresh any time that that would have happened and David has told me he answered no. So from our perspective we need our small growers. We need our growers. We are not relying on the central market floor like we previously were in Coles history many years ago.

MR O’DONOVAN: Okay. So just so we can be clear in case there are growers out there who believe that the consequence of saying no to Coles when they ask for a concession on price or volume, there is no risk of a grower who says no being given a holiday in terms of reduced orders from Coles?

MR TRAINOR: The only risk to reduced orders normally is a consequence of reduced volume through our registers. So if we’re not moving a product through, we would be reducing our upcoming stock coming into the system. Our primary objective is to keep the stock fresh, keep it cool, keep it moving, and that’s what satisfies our customers. So that’s really what we’ve been trying to do over the last few years.

MR O’DONOVAN: Sure, but when volume through the cash register is reduced, are there growers who are specifically targeted because they’re – would a grower be targeted for not receiving an order because they’ve been less co-operative in responding to Coles buyers’ wishes in the past?

MR TRAINOR: In my time, and I can’t speak on behalf of every transaction that took place, it certainly was not a practice that we had as part of doing business.

MR O’DONOVAN: And so you would be confident that Coles buyers would not be engaging in that practice?

MR TRAINOR: In my time absolutely I would be confident, and if there was anything outside of that, that would be outside of our ethical way of doing business.

MR O'DONOVAN: Okay, and that's true for the time being, that as far as you – that no buyer would engage in that practice at present at Coles that you're aware of?

MR STEVENS: I'm not aware of any buyer being implicated by that practice in - - -

MR McMAHON: Not only that, it's against our policy and I think the slight element of confusion there is that in the question there's the term "holiday" which we don't do. There's also the term "would their orders reduce." If our promotion wasn't sharp on an apple or a banana next week then – and we didn't clear the volume that we had, it would impact on future orders simply because we haven't sold the product. That's the only clarification I would add.

MR O'DONOVAN: Okay. Now, in terms of Coles' aggregators who are also operating in that market obtaining product on behalf of Coles, are you aware of them engaging – well, can you confident that they're not engaging in that practice?

MR STEVENS: The practice of not receiving supplies from someone who is not offering - - -

MR O'DONOVAN: Holiday I suppose – reducing their – yes, effectively reducing their orders as punishment for someone not meeting a price requirement or price request of Coles.

MR STEVENS: Well, only so much as – I guess the way we do business is probably the way that they would do business, so that would certainly be a surprise if that were the case. However, I probably can't comment precisely on the aggregator question, but in the way we do business we'd not expect them to do anything different.

MR McMAHON: We would expect them to follow the same policy, but because they are an independent company I can't vouch for that in the absolute. But as I said at the end of the earlier session, we recognise that this is an area which could – in terms of the aggregator dealing with the grower which would lend itself to more transparency and we're open to that in terms of having a single code.

MR O'DONOVAN: All right. That's all I had on that series.

THE CHAIRMAN: All right.

MR O'DONOVAN: Okay. And then I suppose the last question I had is just a general one. It has been noted that Australia is unique among OECD countries in having food inflation higher than the CPI and in a sense that's prompted the inquiry. Do you have any general view about why; why that might be, why that phenomenon shows up in the ABS figures?

MR McMAHON: Yes, we think there are a number of things at work there, none of which are a secret. They are all I think publicly debated. One of which is the drought, so the effect of the drought and the longer term effect of the drought is having an effect through into grain prices in particular. For instance, into cattle prices and other prices. So anything grain fed at the moment is subject to cost increases. There has been the effect of deregulation of areas like the milk market but, more importantly, the growth of export markets. So the growth of export markets in general for skimmed milk, ice cream, and so on into Asia in particular, it's obviously on a smaller scale at this stage but it's not unlike the resources boom. And we're having to compete for the supply of milk liquid with alternate export sources.

And I think they are – sorry, the two big reasons plus the record oil prices filtering through the economy which take a while to feed through, but they are certainly feeding through. So we would say drought, international forces – and particularly the growth of export markets – and, thirdly, record oil prices feeding through the economy would be three things that we would call out.

MR O'DONOVAN: All right.

THE CHAIRMAN: All right. We will go into private session. Thank you. Thanks members of the public. All those not associated with Coles or the ACCC, we will now close the public session for today and we will move to private session. I think our next public hearing is on Friday at 9.15. I beg your pardon, ten.

CONTINUED IN TRANSCRIPT-IN-CONFIDENCE