



Submission to

**ACCC Inquiry into the competitiveness of retail
prices for standard groceries**

March 2008

The Victorian Farmers Federation

The Victorian Farmers Federation is Australia's largest state farmer organisation, and the only recognised, consistent voice on issues affecting rural Victoria.

The VFF represents 19,000 farmer members, representing 15,000 farm enterprises. The VFF consists of an elected Board of Directors, a member representative General Council to set policy and eight commodity groups representing dairy, grains, livestock, horticulture, chicken meat, pigs, flowers and egg industries.

Farmers are elected by their peers to direct each of the commodity groups and are supported by Melbourne-based staff.

Each VFF member is represented locally by one of the 230 VFF branches across the state and through their commodity representatives at local, district, state and national levels. The VFF also represents farmers' views on hundreds of industry and government forums.



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1 Introduction

The sustained upward momentum in food prices over the past two years cannot be fully attributed to the drought. Despite increases in some farm commodity prices, it is incorrect to attribute the full cost of food price increases on these rises in commodity prices.

These increases in food prices, sometimes referred to as 'ag-flation', are going to change the world as we know it. Over the last 12 months, vegetable prices have risen 21.5%, cheese by 8.5%, bread 7.9% and milk prices up 5%.

Growers have informed the VFF that there is a mark up of around 120 per cent on farmgate prices for vegetables; while lettuces fetch between \$1.00 and \$1.20 at the farmgate, they were retailing at \$2.78 in supermarkets this week; parsnips attract \$50 per 10 kg box at the farmgate, but retail at \$9.99 per kg which equates to \$100 per 10 kg box, or a 100 per cent mark up.

Growers are price takers and not price setters. Transparency, competition and fairness through the supply chain must be addressed, in order to ensure that the farm sector, as price takers, does not incur the major impacts of any price reductions at the retail end of the chain.

The price of bread has risen up to 70 cents a loaf in the past twelve months. However, only 14 per cent of this is accountable to higher grain costs. The remaining 86 per cent is the costs of marketers, flour millers, bakers and transporters.

Calculations on additional returns to wheat growers from these price rises only amount to around 10 per cent of the 70 cent rise per loaf, much of which have been reduced through increased farm input costs such as fertiliser, fuel and herbicide. Clearly the drought is not to blame for the price rises.

According to the ABS, the retail price of milk rose over the period December 2006 to December 2007, while the price of beef and lamb remained unchanged. However, the ABARE measure of farm gate prices from July 2006 to July 2007 recorded no change for milk and a 10 per cent and 11 per cent reduction in the price of beef and lamb respectively.

Accordingly, the VFF welcomes the Rudd Governments' inquiry into grocery prices. In instructing the ACCC "to take a broad approach to its inquiry and ensure all aspects of the chain are included - from the farm gate to the check out counter", the scope of the inquiry is much broader than that indicated in initial discussions, that it would just look at retail prices.

Australian milk and dairy prices are rising steadily, with higher milk prices pushing up butter and cheese prices, and wheat prices are at an all-time high. Beef and lamb are forecast to follow, with nationwide livestock shortages taking the average price for a cow from \$700 a head 12 months ago to \$1400 a head going into autumn.

The CEO of Futuris, (owners of Elders Rural) Les Wozniczka has suggested food prices could rise by 50 per cent in the next five years.

In Australia, the current drought, rising petrol prices and higher food standards have made groceries a lot more expensive, and increased transport costs are being passed on to consumers. However the effect of the drought is temporary, and a more important global force is climate change.

Climate change will increase our cost of living and have a significant impact on the food supply. It will also result in new limitations on land use and the push (especially in the U.S.) to replace petrol with biofuel.

A future emissions trading scheme will inevitably push up prices and consumers should brace themselves for sharply rising food prices over the longer term, as farmers face greater variability in growing conditions and government policy directives impact on costs.

The NFF has calculated that an emissions trading scheme which increases energy costs by 10 per cent will reduce farm profitability by 30 per cent. This is incorporating the impact of carbon cost on energy, and expanding the trading scheme to all agricultural emissions would inevitably lead to substantial increases in the costs of food production.

Consumer imposed costs on the supply chain are growing (such as through-chain testing and labelling, comprehensive traceability of food sources and production of new varieties of functional foods) and consumers cannot expect more services without paying for them.

The VFF has long held concerns about the issue of grocery prices, which have risen 43.6 per cent since 1996, compared with CPI rises of 28.8 per cent. Australia is the only country in the developed world where food inflation is higher than the CPI.

The recent OECD report which charts price rises in a number of countries over the past ten years found prices rose faster in Australia, jumping 43.6 per cent since 1996 but just 11.6 per cent in the UK, about 25 per cent in the US and Canada and between 10 and 20 per cent in other European countries.

It is understandable that consumers are concerned about such significant increases, however these price rises are not being driven up by profit increases at the farm gate.

On average, growers currently receive around 20 cents of every grocery dollar spent at the checkout, but given that prices paid by farmers for their inputs have increased enormously, it doesn't make a lot of sense.

Farmers bear a higher risk component in the supply chain and should therefore benefit from higher profits.

The focus of the review should be on creating greater transparency in the supply chain rather than on driving retail prices down to the detriment of farmers, who are price takers. It must aim to ensure fair exchanges and market mechanisms through the complete supply chain, and removal of any impediments to this process. The only way to moderate the impact of increasing prices is to increase efficiencies across the supply chain and production process.

The VFF believes the success of this inquiry relies heavily on the ACCC being provided with the tools necessary to complete the task. This may involve a strengthening of investigative powers afforded to the ACCC. In order to extract accurate and useful information, it is imperative that the Federal Government empowers the ACCC with sufficient authority to access all relevant information.

Despite the rapid increase in food prices, it is interesting to note that since the drought commenced in 1997, farmer terms of trade have declined by 2 per cent.

The VFF questions the value of a periodic survey of grocery prices at supermarkets for a typical shopping basket compiled on a dedicated website. A more useful exercise would be to compare the

prices between various retailers, and address competition issues, which would assist in increasing accountability given that Australia's highly concentrated grocery market is dominated by Woolworths and Coles. A PricewaterhouseCoopers study has found the two supermarket groups control some 78 per cent of the \$74 billion grocery market. This duopsony power can be used to influence sellers and can effectively lower market prices for their supplies.

Primary producers need to regain some degree of pricing power, with food manufacturers passing on higher raw materials costs to consumers. The continued increase in domestic food prices is a pivotal issue for the Reserve Bank as it struggles to contain inflationary pressures.

2 Key concerns for the VFF

The VFF welcomes the opportunity to provide comments to the Australian Competition and Consumer Commission (ACCC) on the competitiveness of retail prices for standard groceries. The VFF has contributed to a substantive submission by the NFF. In summary, our key concerns include:

Farm gate share of retail food prices –There appears to be an increasing gap between farm gate and retail prices.

Retail prices do not always reflect the prices paid at the farm gate - There is not necessarily a direct and immediate relationship between the price of the raw farm input and the final good.

Farm gate prices have many drivers – drought is just one - Contrary to popular belief, drought does not always lead to a lift in prices that farmers receive.

Trade Practices Act

Collective bargaining - The VFF has welcomed changes to the Trade Practices Act (TPA) to further encourage and support farm businesses in collective bargaining through the new Notification process and the streamlined Authorisation. The NFF is disappointed by the minimal interest in the collective bargaining Notification process, suggesting that the new legislation may need to be reviewed to provide further flexibility.

Misuse of market power and unconscionable conduct provisions - The VFF has welcomed efforts to tighten Section 46 and 51AC of the TPA with a view to addressing some of the competition and contractual issues arising from market power imbalances.

The Horticulture Code of Conduct

Background to the Code - The Horticulture Code of Conduct (the Code) was developed to improve the transparency and clarity of transactions between growers and traders of fresh fruit and vegetables within the wholesale sector.

Code Coverage - To reduce confusion regarding the Code, the VFF believes that the Code should apply to all parties involved in the “first transaction from the grower”. This should include retailers, their agents, exporters and processors.

The supermarket duopoly is not relieved by Aldi or Metcash. Coles and Woolworths have a wholesale structure which enables them to set up systems to minimise their risk and have the suppliers pay for it. For instance, QA programs often impose conditions which are unreasonable but which must be complied with to sell the product to the supermarket.

Competition is minimised where there is little true choice. Suppliers have few choices to place large volumes. Consumers have few choices when there is so much private label product. Private labels are at two or three price points for one product – giving the impression of choice, but a different label does not a different product make! The difference between the highest price point and the lowest in private label products is usually just the label. The higher price point means a higher margin for the supermarket, since they usually buy all private label price points of a product at one price and often from one supplier.

Small and independent retailers are often at a disadvantage on price but an advantage on other criteria (i.e. local, fresh etc). However Coles and Woolworths push 'lowest price' continually which gives the perception that others are more expensive – even when they are not.

Pricing to the supplier is based on a tender price which is not the price the supplier receives. The net price is the tender price less levies, e.g. shelf, promotion, head office etc, which may total 20 per cent of tender price. These levies may be deducted before supermarket imposed 'specials'.

'Specials' are financed by the supplier not the supermarket. Suppliers have to agree that they will accept both specials and levies before their tender application is accepted. Consumers do not benefit from lower prices as the supermarket margins include an annual adjustment for increased costs as part of the buyer's budget. The Price Determination report showed that Coles and Woolworths have much higher margins than their equivalents in both the EU and USA. Australian supermarkets have a 24 per cent margin whereas the USA has 16 per cent.

The VFF looks forward to the ACCC's analysis of the competitiveness of retail prices for standard groceries. We urge the ACCC address the issue of transparency in the supply chain, and not attempt to drive retail prices down to the detriment of the farm sector. Drought should not be blamed completely for the recent rise in retail prices and should not be purported to be the only, or even the major cause of higher prices for many food products.

3 Australian citrus supply chain example

Figure 1

Domestic Supply Chain for Fresh & Juiced Valencia & Navel Oranges

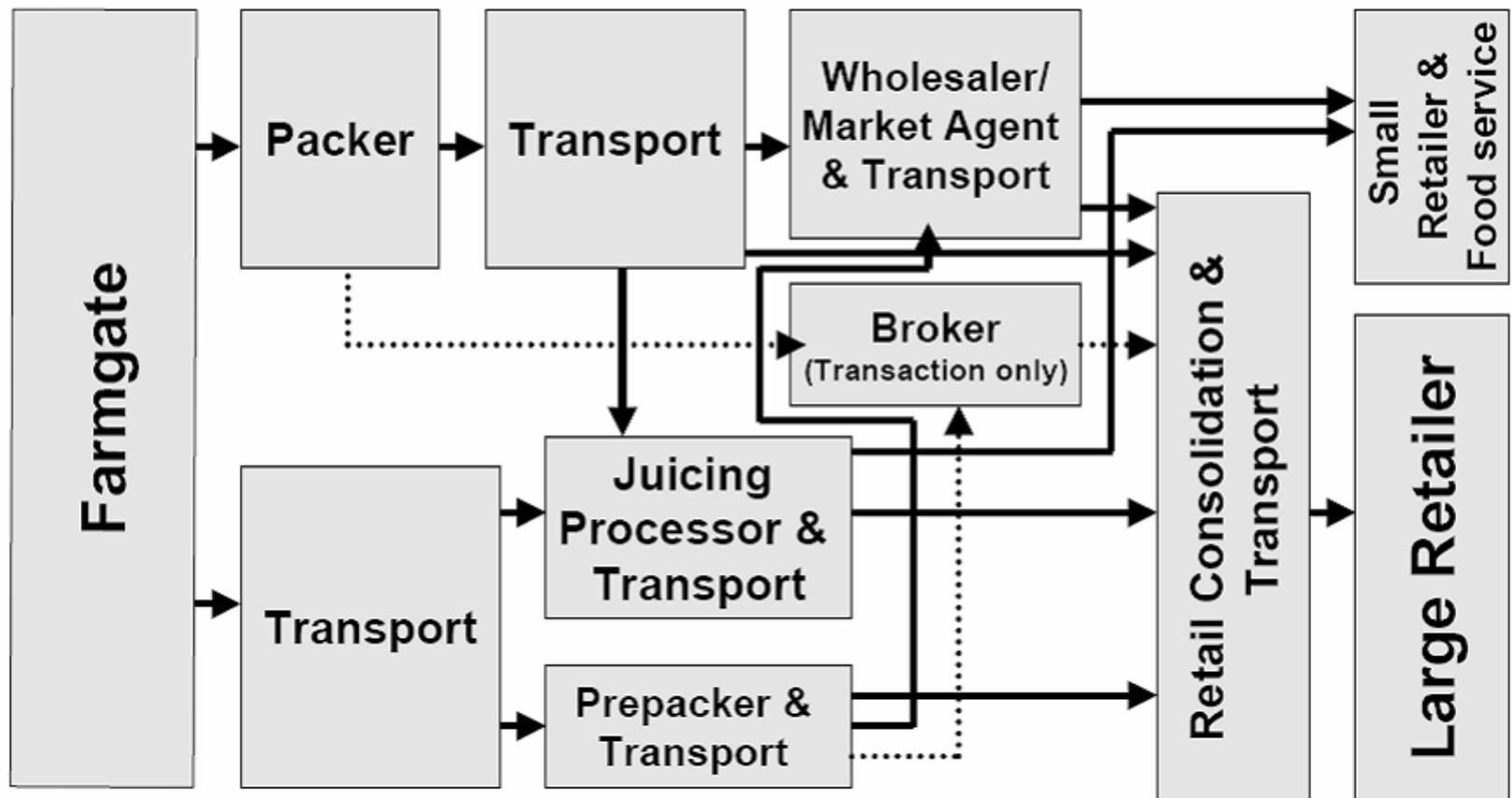


Figure 1 illustrates the stages in the Australian citrus domestic supply chain. Arrows represent a physical flow of product and the broken line represents a transaction only.

Table 1, below, describes the major elements in the domestic supply chain and their value add.

Table 1

Element	Description	Value Added
Farmgate (Grower)	The farmer who grows and harvests the oranges and for some distribution channels will also grade fruit.	<ul style="list-style-type: none"> • Production • Harvesting • Grading
Packer	The organisation that receives, sorts, grades, packs and provides short-term storage for the packed oranges. This element also coordinates transport and in some instances holds supply contracts with the major juice processors.	<ul style="list-style-type: none"> • QA (Quality Assurance) • Grading • Packaging • Coordinating transport and negotiation • Controlled environment short term storage • Contract supply of juicing oranges
Transport	The provider of transport to move products between Farmgate, Packer, Juice processor and Pre-packer. This involves moving the product to a specified location, whilst handling the product in specified and monitored conditions and making delivery within a target timeframe.	<ul style="list-style-type: none"> • Controlled environment transport
Pre packer	The organisation that receives shed graded bins of oranges and then packs product into the net bags. Forward transport is then organised. Some pre packers will buy ungraded oranges and then grade and wax fruit.	<ul style="list-style-type: none"> • QA • Grading & waxing • Prepacking • Transport
Juice processor and transport	The organisation that converts juicing oranges into the retail packs of fresh orange juice.	<ul style="list-style-type: none"> • Processing fresh oranges into retail and food service ready juice products • Marketing and distribution
Wholesaler/Market Agent	The organisation that sells product on behalf of the grower or pack house. This usually involves short-term handling and storage of the product. These organisations are typically servicing a wide range of clients. There are indications of trading in product within this element prior to reaching the end purchasing.	<ul style="list-style-type: none"> • Marketing & selling and distribution to retailers and the food service sector. • QA • Controlled environment holding storage

Broker	An organisation that coordinates the direct dealing between growers/packers and retailers. These organisations are typically servicing a small number of high volume clients and for the role they play in this type of transaction they don't require hard facilities to handle the oranges.	<ul style="list-style-type: none"> • Marketing & selling • QA
Retail consolidation and transport	The point at which the full range of retail fruit and vegetable are received and then sorted into retail store orders. A retailer can operate this function or it can be sub contracted out to a Logistics Service Provider.	<ul style="list-style-type: none"> • Cross Docking • QA • Short term storage • Controlled environment • Transport
Retailer	The organisations that operate retail stores that sell the oranges along with other fruit and vegetables.	<ul style="list-style-type: none"> • QA • Consumer distribution • Promotion

Oranges are sold in both loose by the kg and also in prepackaged form. Prepackaged product delivers a lower per kg income, therefore if the proportion of total sales of loose and prepackaged product alters, it will impact on income for all elements of the supply chain, and most significantly on grower returns.

Retailers often request that packers/growers lower prices to enable promotional activity, and then invest in effective promotional activity to generate higher volumes. This results in lower returns to growers.

Sometimes product is sold between wholesalers before it is sold to a retailer or food service customer. The effect of this is difficult to quantify given the low visibility of trading data, however it is apparent that this supply chain path has the effect of decreasing grower returns and increasing retail prices.

This supply chain would benefit strongly from improved visibility of trading information, which would allow the true value-add of these practices to be ascertained. This sharing of data has substantial barriers to overcome.