



Submission to the
**Australian Competition and Consumer
Commission**
on the
**Inquiry into the competitiveness of
retail prices for standard groceries**

March 2008

Growcom submission to the ACCC inquiry into the competitiveness of retail prices for standard groceries

Growcom has publicly welcomed the announcement that the Australian Competition and Consumer Commission (ACCC) is undertaking an inquiry into the competitiveness of retail prices for standard groceries. We understand this inquiry will investigate the barriers to competition and factors influencing pricing at each stage of the supply chain from farm gate to check-out counter. The horticulture industry applauds the initiative and welcomes the inclusion of fresh fruit and vegetables within the scope of this inquiry.

Growcom appreciates the opportunity to provide a submission to the ACCC inquiry on the competitiveness of retail prices for fresh fruit and vegetables. We are supportive of the submissions provided by Horticulture Australia Limited (HAL) and Horticulture Australia Council (HAC). However, Growcom would like to provide some additional feedback on behalf of the Queensland horticulture industry.

This submission will provide additional feedback on:

- Growcom's overarching policy position on the horticulture business environment;
- Production costs and constraints on horticulture enterprises in Queensland;
- The environment and supply chain in which horticulture enterprises operate;
- Issues raised by the Queensland horticulture industry in relation to the market dominance of the major supermarkets; and
- Effectiveness of the Horticulture Code of Conduct.

We anticipate the submissions provided by ourselves, HAL and HAC will be taken into consideration by the ACCC during this inquiry.

1. About Growcom

Growcom is the peak representative body for the fruit and vegetable growing industry in Queensland, providing a range of advocacy, research and industry development services to the sector. We are the only organisation in Australia to deliver services across the entire horticulture industry to businesses and organisations of all commodities, sizes and regions, as well as to associated industries in the supply chain. We are constantly in contact with growers and other horticultural business operators. As a result, we are well aware of the outlook, expectations and practical needs of our industry.

The organisation was established in 1923 as a statutory body to represent and provide services to the fruit and vegetable growing industry. As a voluntary organisation since 2003, Growcom now has grower members throughout the state and works alongside other industry organisations, regional producer associations and corporate members. To provide services and networks to growers, Growcom has approximately fifty staff located in offices in Brisbane, Bundaberg, Ayr, Toowoomba and Tully. Growcom is a member of a number of state and national industry organisations and uses these networks to promote our members' interests and to work with other industry bodies on issues of common interest.

2. About the Queensland horticulture industry

Queensland is Australia's premier state for fruit and vegetable production, growing one-third of the nation's produce. Horticulture is Queensland's second largest primary industry, worth more than \$1.7 billion per annum and employing around 25,000 people. Queensland's 2,800 farms produce more than 120 types of fruit and vegetables and are located from Stanthorpe in the south to the Atherton Tablelands in the far north. The state is responsible for the majority of Australia's banana, pineapple, mandarin, avocado, beetroot and fresh tomato production. There are 16 defined horticultural regions with a total area under fruit and vegetable production of approximately 100,000 hectares.

The Queensland horticulture industry is:

- A major contributor to regional economies and the mainstay of many regional communities;
- The largest high quality supplier of fresh fruit and vegetables to Australian consumers;
- A diverse industry utilising a range of production methods in different locations and climates;
- A resource base for significant value adding throughout the food, transport, wholesale and retail industries;
- The most labour intensive of all agricultural industries, with labour representing as much as 50% of the overall operating costs;
- An industry with significant links to the tourism industry, providing income for thousands of backpackers and "grey nomads" each year;
- A high value and efficient user of water resources in terms of agricultural production;
- A primary and secondary source of income for many families in regional Queensland e.g. through seasonal work in packing sheds; and
- The site for a number of emerging agricultural industries including olives, Asian exotic tropical fruits, culinary herbs, bush foods, functional foods and nutraceuticals.

3. Overarching position on the horticulture business environment

Growcom expects that horticultural producers will be able to operate in a reasonable business environment, with opportunity for fair competition. We believe this environment should have:

- Transparent relationships in the value chain;
- Relationships between suppliers and customers that are not distorted by market power;
- Opportunity for market growth by meeting consumer demands;
- A degree of certainty with respect to regulation and resource access;
- Reasonable cost of doing business; and
- Reasonable sharing of risks and rewards.

We are committed to improving the business environment in which growers operate, through the value chain and the regulatory environment, and by providing pathways to practical outcomes for members, including continuous improvements in agriculture, marketing and business. As part of this commitment, Growcom is providing this submission to the ACCC to ensure the interests of the Queensland horticulture industry are addressed during this inquiry.

4. Production costs and constraints on horticulture enterprises in Queensland

Growcom believes it is essential for the ACCC to investigate production costs and constraints on horticulture enterprises when analysing the competitiveness of retail prices for fruit and vegetables. We support the information provided in the HAC and HAL submissions, and would like to provide supporting information on behalf of the Queensland horticulture industry.

The fruit and vegetable industry is made up of small, medium and large enterprises operating with a range of business models and markets. The environment in which these enterprises operate is highly commercial and extremely competitive. Business development and value chain, biosecurity, climate variability, natural resource management and labour issues affect all of these businesses to different degrees. All of these issues and associated costs place enormous pressures on horticulture businesses and continue to have large impacts on growers' bottom line.

Generally, there are various input costs that growers encounter in the every day running of their businesses. These input costs include, but are not limited to:

- Land preparation;
- Planting and crop management;
- Fertiliser;
- Weed control;
- Insect control;
- Disease control;
- Irrigation;
- Harvest and post harvest activities;
- Packaging;
- Marketing;
- Labour;
- Fuel; and
- Freight to market.

Input cost structures may vary substantially from business to business and are influenced by a variety of factors including commodities grown; climate and access to water; location; and distance to market.

Production costs and the price of key inputs continue to rise, often at rates much higher than the general rate of inflation. However, it is well established that horticultural growers are price takers, so have little or no capacity to pass cost increases up the supply chain.

These challenges are compounded by the concentration of the domestic fresh food market within the two major retailers. There is a clear trend of these retailers using their market power to push costs, risks and responsibilities back down the supply chain. Anecdotally, ten years ago growers worked on a rule of thumb of farm gate return being around 50 per cent of retail price. Today, this margin is generally less than 20 per cent. Growers' profit margins continue to decrease, while the profit margins of the major retailers remain at record highs.

5. Horticulture industry supply chain and operating environment

Growcom supports the information provided in the HAL and HAC submissions relating to the horticulture industry supply chain and operating environment. We would like to provide some supporting information on behalf of the Queensland horticulture industry.

Growcom commissioned a detailed study on the horticulture supply chain in 2004. The key findings of this study included:

- The horticulture value chain is relatively short as the product goes through few, if any, transformation steps prior to consumption;
- The vast majority of growers grow independently of others;
- There is a greater focus on the domestic market, which is generally oversupplied, has many producers, is strongly competitive and in terms of communication and price transparency relatively dysfunctional;
- Retailers having enormous power down the chain as they strive to secure the consumer dollar, which is driving the structure and nature of produce;
- There is a marked reduction in the number of suppliers being used by the major retailers;
- A greater focus on the use of information technologies (IT) across the chain to provide improved information and communication dissemination;
- There was limited evidence of the use of formal contracts specifying the nature of the business relationship between producers and wholesalers; and
- There are limited risk management strategies being undertaken by producers; and the range of options is limited. However, some more sophisticated growers are undertaking such strategies such as growing products across a variety of regions to minimise the impacts of adverse weather events.

The final Regulatory Impact Statement on the Mandatory Horticulture Code of Conduct included further information in relation to retailers and the horticulture supply chain:

- Major retail supermarkets are increasingly assuming direct responsibility for managing and developing the distribution processes and reducing the market share of wholesalers, including the central markets;
- Food retailers are extending contractual arrangements downstream and developing exclusive supply arrangements directly with farmers to facilitate greater control over stocks as well as the quality and price of produce;
- The major supermarket chains currently source 50 to 70 per cent of their fresh fruit and vegetable offering directly from growers, and top up the rest by purchasing from wholesalers. They maintain significant facilities in wholesale markets to support procurement and distribution of many major lines of fresh fruit and vegetables; and
- The major retailers specify and adhere to very strict quality standards and use their purchasing power to drive hard bargains with growers, but compensate by offering them prompt payments as well as certainty and more stable revenue streams.

Overall, the contrast between the market power of the retail chains compared to the market power of the typical grower is enormous. Within Queensland, there are approximately 2,800 horticultural enterprises – and they are in a very weak bargaining positioning in comparison to that of the two major retailers and the c50 wholesaling businesses in the Brisbane Markets.

To a large extent these growers compete vigorously with one another and with growers in other parts of Australia, and even overseas.

Growcom believes that an imbalance of power market of this magnitude carries with it a commensurate responsibility to ensure that business dealings with growers are fair, reasonable and transparent.

Within this operating environment, there are a number of challenges faced by growers as a result of characteristics of the industry and the products they produce. These challenges are probably not matched to the same degree in any other rural industries. These challenges include:

- Perishability – Once horticulture products are harvested, growers do not have the luxury of being able to hold or re-direct consignments if prices are not satisfactory. Growers are price takers, with the returns they get in the hands of wholesale merchants, agents and retailers for whom the bottom line is to maximise the margin between buying and selling price. Growers are generally obliged to accept the price being offered and in many transactions they can not be regarded as ‘willing sellers’. Failure to accept a price on offer usually means return of a consignment with little prospect of salvaging any value.
- Market volatility - Independent action by hundreds of sellers can very rapidly over-supply a market once a fruit or vegetable crop has reached maturity and has to be harvested. Whilst a small percentage of growers from particular regions may be able to supply a market before the bulk of supply is marketed, most growers are obliged to market their product at the same time. This gives rise to a high degree of price volatility over which growers have little control. Typically growers respond to favourable price information only to find that many others have done likewise with the end result being that prices actually realised fall well short of the level which induced them to supply in the first place.
- High degree of risk exposure – This is another characteristic which must be recognised in any business arrangement established between growers and those to whom they supply and market. Many horticulture products are susceptible to damage that can reduce the quality of the product, such as exposure to weather, sunlight, high temperatures, fruit flies etc. Any exposure to the elements can have large impacts on the quality of the produce and associated attractiveness to potential buyers and consumers.
- Market risk - the perishable nature of the products and the inability of individual growers to know what quantities will be supplied on any particular day, both constitute significant risks. Other market risks include unpredictable changes in trade policy by overseas countries and the growing concentration in market power by the two major retailers.

While better technology both on the farm and through the marketing chain has helped growers to alleviate some of the risks associated with their industry, these risks still exist and manifest themselves through reduced output and diminished profitability. Examples are the wide range of pests and diseases which can flare up at any time and the risk of adverse weather conditions such as droughts, frosts, cyclones and hailstorms.

Overall, there are many challenges being faced by individual horticulture producers, especially when taking into consideration production costs and constraints, supply chain aspects and other factors which influence the viability of these businesses. The future operating environment is of real concern to the industry, with the market power of the retail chains significantly adding to these concerns.

Considerable effort is required by government and industry stakeholders to ensure farming enterprises can operate in a reasonable business environment with opportunity for fair competition. Efficient and effective markets are in the best interests of growers, consumers and Australia as a whole.

6. Issues raised by Queensland horticulture industry relating to market dominance of the retail chains

There is continuing concern within the Queensland horticulture industry on the market dominance of the major retail chains and the associated impacts on individual producers and the industry. Underlying these concerns is an expectation that growers should receive a fair proportion of the consumer dollar for the crucial role they perform in producing the products that the members of the supply chain and consumers seek. Growers want to feel confident that they are not being exploited by other supply chain participants who are in a position to do so either because of a power imbalance or a trading environment that impedes market signal/information flows.

The current operating environment has not alleviated the concerns of growers. Data shows that the price of fruit and vegetables to consumers is increasing at a far faster rate than the returns to farmers. Many growers are concerned that the market power of the major chains enables them to drive very hard bargains in the purchase of produce, which is often done in an aggressive manner. However, the experiences of growers has been mixed, with some believing they are not treated in a fair and business like manner but with other growers reporting good business relationships and convinced that direct supply represents the best marketing strategy for the future.

Growcom wishes to provide feedback to the ACCC on concerns that have been raised by the Queensland horticulture industry in relation to the market dominance of the major retailers. These concerns include:

- Conflicts over pricing, the level of sales proceeds. This includes the perception that growers are not receiving a fair proportion of the consumer dollar – margins are not visible along the supply chain;
- Inadequate notice and/or lack of consultation before mandating changes to product packaging and quality specifications;
- Market behaviours that influence central wholesale prices which are then used to negotiate for direct suppliers;
- Punitive behaviour designed to enforce desired behaviours by suppliers (eg issues associated with 'being made to take a holiday' and return of product). There is a fear of retaliation/victimisation amongst growers;
- Squeezing wholesalers on price and volumes;
- Fresh produce margins of major supermarkets increasing substantially in the past decade;

- Deliberate forcing down the supply chain of disadvantageous or less cost-effective production or marketing processes by retailers. This includes cost cutting for retailers but not for growers;
- Absence of a trail re quality – to identify where problems occurs and where responsibility lies;
- Delays in notification of rejected product with insufficient time to re-sell. This includes returning of product after delivery has occurred;
- Use of quality claims as a basis for returning over-ordered stock and/or lowering the price;
- Retailers continuing to push all responsibilities back down the supply chain to growers. There is no clear line of where fruit changes ownership. Growers appear to be held wholly responsible until sold to the consumer;
- Handling of stock in supermarkets and damaging of product once in stores. There is also a lack of understanding on treatment of certain commodities ie tropical fruits;
- Expected to deliver immediately on demands of retailers;
- Market price setters, as result of large share of produce market;
- There is a lack of data collection to give more accurate picture;
- Woolworths taking 'ownership' of product, removing any reference to grower or farm;
- Retailers not willing to share costs of achieving high quality control. Auditors, appointed by retailers, demand high fees;
- Growers unsure of their position when product is ordered, orders are fulfilled and then the order is cancelled.

There is concern that the absence of specific complaints to the Ombudsman about abuse of market power is seen as reflecting satisfaction with the system, when in fact it reflects the extent of the power imbalance coupled with weaknesses in the Code for tackling systemic problems. The potential for fear of retaliation or victimisation is most likely to be a factor in circumstances where there is great imbalance in market power between parties, and where possible adverse consequences on long-term viability are considerably greater for one party relative to the other. This type of behaviour is a deliberate abuse of market power (unlawful trading) and needs to be dealt with by the law.

7. Effectiveness of the Horticulture Code of Conduct

Growcom would like to provide feedback on the effectiveness of the Horticulture Code of Conduct. We are aware of many examples where the Code has lead to successful business relationships and trading behaviour between growers and wholesalers. This includes Code-compliant merchant and agent Horticulture Produce Agreements (HPAs) successfully operating within the industry. We have also heard of positive business relationships a number of growers have with the major retail chains, where orders and price are known well in advance.

However, there is overall non-compliance with the Code within the horticulture industry. Growcom is aware of many operating outside the regulations, whether that be on back-dated contracts; agreements that are not code-compliant; or without any contractual agreements at all. The vast majority of HPAs originate from the wholesaler, with many containing non-Code complaint clauses that ultimately benefit the wholesaler. If a grower has tried to obtain a compliant HPA, no room is given by the wholesaler for negotiation. There are very few examples of contracts that have originated from a grower, with the majority of these being

rejected by the wholesaler in any case. Unilateral contract setting still prevails, as the wholesalers continue to distribute non code compliant contracts.

Many growers are still being intimidated (or believe the wholesalers rhetoric which aims to confuse growers by not supplying clear and accurate information on the Code) to sell their produce (frequently highly perishable and with a short season) on the wholesalers' terms; because the alternative is to have no avenue in which to do business. Many growers are just signing non-compliant HPAs to "get on with business". Many did make complaints and provided non-Code compliant HPAs to the ACCC, however the lack of action and enforcement has left growers with no option but to do as the wholesaler tells them. There are also examples of growers being "black listed" by all wholesalers in one or more of the central markets if they attempted to negotiate a compliant agreement, or raise issues or complaints with the ACCC. There is also a clear campaign by some wholesaler organisations to insist that their members act only as merchants and not as agents (even though in practice many are still acting in a "hybrid" manner).

As a consequence, the lack of public enforcement measures by the ACCC has resulted in the Code not yet addressing either of the major issues of the imbalance of power in the marketplace it was established to tackle; and the issues of market failure.

The misapplication of the Code by wholesalers has been heightened by the lack of enforcement by the ACCC. All of these behaviours by wholesalers and the lack of overt action by the ACCC are undermining the intent and implementation of the Code. This is a major issue which requires immediate and intensive action, particularly emphasising enforcement. Overall, events in the months since the Code was made law have demonstrated that wholesalers will not operate in an open and transparent manner.

Feedback commonly received is that the Code has no strength or impact as there has been no enforcement or any penalties associated with doing the wrong thing. The ACCC has relied on growers and grower organisations to provide information on non compliance. However, this strategy has not been successful in leading to compliance. Industry has been pushing for the ACCC to adopt strategies that are more likely to be successful in the horticulture industry, but this information has largely been ignored. The general impression within the industry is that the ACCC is a "toothless tiger" that is continuing to allow massive non-compliance with no penalties attached. This impression is prominent in the wholesaler sector and therefore it is highly unlikely that the current situation will change until the ACCC takes visible action against those knowingly breaking the law.

Growcom submits that there must be ongoing and active enforcement of the Code, including the ACCC being more overt in their policing, such as public visits at wholesalers' place of business to match consignments with HPAs, which is likely to get more compliance quicker and more broadly than individual legal action. We have raised this idea with the ACCC, however they have resisted establishing a presence in the markets as they do not believe there is massive non-compliance despite significant evidence to the contrary.

The ACCC appears to be relying on gathering evidence via industry sources (growers, industry groups) to make a case against one or more wholesalers. However, experience indicates that growers are unwilling to step forward and complain for fear of retribution. The ACCC needs to adopt enforcement strategies that are more likely to be successful in this industry. Overall, many wholesalers' continuing bad behaviours and non-compliance with the

Code undermines the regulations and the credibility of the ACCC, Government and the industry.

Due to the massive non-compliance of the Code, it is difficult to assess its effectiveness as it is not actually operating as required in the legislation. The only way recalcitrant players will be brought into compliance is through a real threat of punishment. Thus the Code must be not only enforced appropriately by the ACCC – but it must be seen to be enforced.

Furthermore, an extensive education and information campaign needs to be implemented and maintained to gain a higher level of awareness and understanding within the industry. Generally, there is limited awareness of the ombudsman and the dispute resolution processes, as there is limited promotion and no apparent communication campaign underway.

If these things happen, Growcom believes that the Code will meet its purpose to encourage greater clarity and commercial transparency in trade transactions between growers and wholesalers by clarifying the responsibilities and obligations of each.

8. Further information

Growcom submits that the ACCC review the below sources for more information. We can provide any of these documents on request.

- UK Competition Commission (2007). *Working paper on supply chain practices and the Supermarkets Code of Practice*.
- Growcom (2004). *Horticultural value chain analysis and policy development*.
- Australia Government Department of Agriculture, Fisheries and Forestry (2004). *Price determination in the Australian food industry*.
- Neill Buck & Associates (2003). *Report of the review of the retail grocery industry code of conduct*.
- Horticulture Australia Limited and Horticulture Australia Council (2003). *Strategies for achieving fair competition in Australia's horticultural business chains*
- Joint select Committee on the Retailing Sector (1999). *Fair market or market failure? (Baird review)*
- UK Competition Commission inquiries on supermarkets

It is impossible for industry to obtain data that allows us to answer many of the questions raised in the issues paper. Growcom submits that the ACCC needs to use their investigatory powers to obtain information that would be beneficial in this inquiry, such as profit margins throughout the supply chain from growers to retailers.

9. Conclusion

Growcom is supportive of the submissions provided by HAL and HAC.

Overall, production costs and the price of key inputs continue to rise, however it is well established that horticultural growers are price takers, so have little or no capacity to pass cost increases up the supply chain. These challenges are compounded by the concentration of the domestic fresh food market within the two major retailers. There is a clear trend of these retailers using their market power to push costs, risks and responsibilities back down

the supply chain. Growers' profit margins continue to decrease, while the profit margins of the major retailers remain at record highs.

The balance of commercial power and advantage is unfairly and unreasonably weighted against the growing community. This situation is limiting the ability of horticulture producers to operate within a reasonable business environment, with opportunity for fair competition.

Growcom believes that this inquiry could be an important mechanism for recognising and acknowledging the unsustainable pressures this market failure places on individual producers - and the entire horticulture industry.

If the scales are not more fairly balanced, many producers will go out of business. This will reduce the availability of healthy, locally produced fresh fruit and vegetables and further exacerbate price pressures on all Australian consumers.