

Public Submission to ACCC Grocery Inquiry by Apple & Pear Australia Limited on 11 March 2008.

Executive Summary

- Transparency in all transactions in the supply chain from the grower/producer, regardless of the path to market, is imperative if consumers are to benefit in terms of price paid and quality offered.
- Transparency is also important in the process of apportioning reward to risks taken in the supply chain. Growers/producers carry the majority of risk in the business of supplying apples and pears to consumers and have no ability to fix a margin as is possible in all other components of the supply chain.
- Consumers now enjoy the ability to purchase an extensive range of high quality apples and pears throughout the year and in many cases the opportunity to purchase '24/7'. This convenience comes at a cost which ultimately must be borne by consumers.
- The overwhelming driver of price in the marketplace for apples and pears is the force of supply and demand. However the lack of transparency in the supply chain often blurs the signals back to growers/producers.
- Transparency in retail pricing across fresh product lines is strongly urged as there is some suggestions that major volume product lines like apples are used to 'subsidise' some exotic/niche product lines.
- It is important that all participants in the supply chain have access to reasonable supply and demand information.
- Consumers are not always provided with their preferred choice of size and quality of apples due to the limited range offerings by the MSC's. This can impact negatively on consumer demand and grower/producer returns.
- It is doubtful that the Australian grocery industry could sustain a third supermarket chain the size of Coles and Woolworths. Consumers may gain in the short term with increased price competition however in the longer term there may be reduced growers/producers and lower supplies due to unsustainability and lack of fair reward.
- The Horticulture Code of Conduct must be resolved into a workable contracting vehicle to ensure that appropriate transparency occurs across all segments of the supply chain.

Overview comments

Growers/producers have a range of views about the structural arrangements within the retail and related supply chain management of fresh apples and pears in Australia. Some growers/producers argue that the duopoly power exerted by the two major supermarket chains (MSC's) unfairly affects their viability by demanding higher and higher compliance standards in respect to quality (which include size, shape and colour specifications which in turn limits

available produce) and extracting an unreasonable or higher than expected margin in the price paid by consumers. Others argue that the continuing lack of transparency between the growers/producers and the wholesale market sector and the packer/marketer have a greater influence on their viability. However there is no argument that Australian consumers now enjoy excellent access to high quality produce throughout the year served by a retail sector that consists of two MSC's, smaller independent supermarket chains, a large number of small independent fruit and vegetable retailers, an emerging segment of high quality fresh produce independents who are forming chain operations in key markets and a developing food services sector including alternative snack type products.

It is recognized that these retail offerings require significant infrastructure and investment which impact on the margins required by retailers to maintain commercial viability and this ultimately affects the prices paid by consumers. Growers often complain about the continuing pressure from MSC's to provide higher compliance standards to produce. These pressures inevitably cost the grower who has very limited ability to pass on costs to wholesalers or retailers.

This submission provides responses and comments to many (but not all) of the questions raised in the issues paper as follows:

Responses to Questions raised in Issue paper

Q.1 What have been the major causes of rising food prices in Australia (e.g. drought, transport costs, etc.)? In particular, what have been major causes of the rising prices of products such as milk, cheese, bread, fruit and vegetables?

Rising food prices in Australia have been impacted by a number of factors in recent years. From a producers perspective the following factors have had an influence:

- Apples and pears have been significantly impacted by the effects of drought and related weather influences (e.g. frost and heat damage) causing supply constraints
- Higher oil prices resulting in increased fertiliser, chemical and transport costs
- Higher labour costs – superannuation, training associated with QA
- Higher machinery costs - PLU sticker machines, carton labels, higher volume equipment
- Higher water costs
- Compliance cost of government OH&S, Statistics, MRL's
- Compliance cost of doing business with MSC's – reusable crates, specific QA systems tailored for each supermarket
- Protection systems to ensure regular supply and to ensure less impact on native bird and bat populations

It should be noted that the higher costs for producers do not impact on prices paid by consumers. Prices are basically set in the wholesale market system and these are totally driven by the market forces of supply and demand. In times of shortage prices paid by the wholesalers and MSC's typically rise and consumers pay more; when supplies are

more plentiful growers inevitably receive lower prices, however consumers do not always receive the full benefit of these market factors.

Q.2 Do the OECD comparisons accurately reflect the relative rates of food price inflation in Australia and the OECD countries? Are there other more relevant comparisons? Are there a more appropriate set of countries to compare Australia's food price inflation?

OECD comparisons in the recent past (since first quarter 2005) show Australian price indices are significantly higher than OECD; this can be explained by serious drought, severe weather events (cyclones, frosts, heat wave). Over the longer term the Australia index is below OECD suggesting that the recent inflationary effects are not out of order. Experience and observation from travel to many developed economies suggest that for many basic food items including meat, dairy and fruit/vegetables are still cheaper in Australia.

Grocery retailing

Q.3 What have been the major changes to the structure of grocery retailing in Australia over the past 5 to 10 years?

Major changes to the structure of grocery retailing over the last 5 to 10 years has been the consolidation to two major supermarket chains who retail 60 per cent of Australia's apples/pears. The introduction of increased trading hours has also had a big influence on where major chains have the labour resources to meet 7 day trading and longer hours for the convenience of the consumer.

Q.6 What are the most appropriate ways of measuring the shares of grocery retailers (value of sales, number of stores, areas of floor space, etc.)? Should industry or market shares be measured across all grocery items or for particular product categories (such as packaged food, bakery products, meat, fruit and vegetables, delicatessen products, etc.)? If possible, please provide quantitative estimates of shares of grocery retailing detailing the data sources and any assumptions made in estimating the shares. How have these shares changed over the past 5 to 10 years?

APAL believe that retailers extract greater margins from some grocery items than others and therefore we strongly support more transparency in pricing across product lines. There is significant concern (along with some anecdotal evidence) that supermarket chains extract 'extra' margin from some categories of fresh produce (particularly high volume 'staples' like apples) and 'subsidise' some of the higher cost 'exotic' or niche products. The effect is that consumers pay higher prices for these 'extra' margin products, demand is subsequently reduced and suppliers of these products are disadvantaged.

Q.7 Please provide details of recent entry and exit in grocery retailing including the reasons for the success or otherwise of new entry and the reasons for exit.

Aldi supermarkets is a new entrant into grocery retailing in Australia and it is evident that they have introduced some benefits to consumers in the form of aggressive low

prices. However Aldi has been ruthlessly tough on suppliers compared to the MSC's and as a result they tend towards the end of the list of preferred outlets for growers. Consumers may lose out ultimately if suppliers are continually 'screwed down' on price forcing producers out of the industry. Reduced supply will result in higher prices and potentially less consistent quality.

Q.9 How profitable are grocery retailers? What margins over wholesale costs do grocery retailers achieve? Do margins and profitability differ by the size and location of the store? If so, how? What rate of return on capital do grocery retailers achieve? Has this changed over the past 5 to 10 years?

Typical mark-ups noted in fresh produce retail for apples/pears are 80-120% over grower/producer farm-gate prices. 'Specials' are generally lower mark-ups at 40-60%. Niche/specialty lines of product could be marked up by greater than 120%.

Grocery wholesaling

Q.10 What have been the major changes to the structure of grocery wholesaling in Australia over the past 5 to 10 years?

The number of participants in the grocery wholesale sector has reduced and category managers have emerged as the managers of the major portion of fresh produce moving from farm to retail over the last five to ten years. There has been a consolidation in the number of suppliers selling direct to supermarkets (smaller growers/producers cannot supply direct but go through a category manager/supplier or wholesaler/broker). Category Manager/Suppliers are typically large grower/packers/marketers or co-operatives with integrated packing facilities or wholesaler/brokers.

Q.11 What factors have driven these changes (such as cost savings from large-scale wholesaling operations, changes to the structure of grocery retailing, mergers and acquisitions, etc.)? What has been the relative importance of these and other factors?

The structural changes have been driven by supermarkets seeking greater efficiencies in the accumulation of product lines by reducing the number of individual suppliers. This reduces administration costs to the MSC and pushes the responsibility back on category managers/suppliers to meet supply requirements.

Q.12 In what ways (if any) do grocery wholesaling operations and arrangements differ by product categories? Please provide details.

Wholesaling operations and arrangements are broadly similar across the fresh produce category. Anecdotal evidence also suggests that the MSC's work on a net profit of 8% for fresh produce and only a 5% net profit for other grocery items. This could be due to fresh produce not 'buying' shelf space, but fresh produce does have to 'pay' a 2.5% settlement discount. Commercial agreements are not generally known between sectors or even within sectors.

Q.13 How important are economies of scale in grocery wholesaling? What are the sources of these economies of scale? Are economies of scale primarily the result of lower transport costs, lower storage costs, better stock management or the ability to negotiate better deals with suppliers?

Economies of scale are important – improved cost efficiency in logistics and administration. Scale is also important in the maintenance of quality and consistency. However there is little or no evidence that economies of scale or other efficiencies enable supply chain partners to negotiate better deals with MSC's or other higher levels in the supply chain.

Q.14 What are the most appropriate ways of measuring the shares of grocery wholesalers? Should industry or market shares be measured across all grocery items or for particular product categories (such as packaged food items, bakery, meat, fruit and vegetables, delicatessen products, etc)? If possible please provide quantitative estimates of shares of grocery wholesaling detailing the data sources and any assumptions made in estimating the shares. How have these shares changed over the past 5 to 10 years?

As with the comments applying to retailers, APAL believe that there needs to be more transparency in pricing between product categories and even between specific fruit and vegetable lines.

Q.16 How profitable are grocery wholesalers? What margins over supply costs do grocery wholesalers achieve? Do these margins differ by size of the wholesaler? If so, how? What rate of return on capital do grocery wholesalers achieve? Has this changed over the past 5 to 10 years?

Fresh produce wholesaling can be extraordinarily profitable businesses that can extract extraordinary margins in consideration of the minimal risks normally taken. The Horticulture Business Code has attempted to address these matters with greater transparency, however there is little evidence to suggest that this has been achieved. It should be noted that the MSC's Distribution Centres act as the wholesaling division for the MSC. Ideally price additions to each level of the supply chain should take into account supply and demand factors, and be based on cost plus risk plus profit. Percentage mark-ups do not necessarily have any relevance to cost, risk and profit, for example, a low supply item increases in price but the supply chain cost of transport and cost of 'putting it on shelf' do not increase due to low supply. Wholesalers in the central market system are particularly secretive and very little is known about their costs.

Understanding the grocery supply chain

One of the key issues in the fresh produce supply chain is the lack of widespread knowledge about supply/demand factors in the market at any given time. Unfortunately the weakest seller tends to set market values and this often occurs with the grower/producer not having good market knowledge. In addition there is often a lack of transparency and knowledge in pricing and costs from supplier to retailer. This applies along the supply chain from grower/producer, to pack-house, to category manager/supplier or wholesaler/broker and then onto retailer. The

impact is that unreasonable margins can be extracted, usually at the expense of consumers and in most instances to the detriment of grower/ producers.

Consumer behaviour /consumer choice issues

As noted in the issues paper, retailers often use margin pricing policies on high volume products (like apples) to attract customers. While this strategy can be beneficial to growers/producers if they are keen to move volume, it almost certainly comes at a cost to growers/producers as they are required to reduce prices to support the discount promotions. Growers/producers do have a choice in whether they participate in these promotions and are provided the opportunity to provide promotional options to MSC's. In some instances where the grower/packer does not have effective control of product, (ie. stored off farm and under control of a category manager/packhouse) fruit is sold to meet requirements of continued supply.

Supermarkets determine size of apples stocked as part of their quality specifications. Small fruit is often sold in pre packs which in some instances requires specialised packaging not available to all grower/ packers. This specification often forces producers to sell smaller sizes of equivalent quality at discounts through alternative outlets or send them to specialised packers. Apple and pear growers believe that consumers are not being provided with enough choice by the MSC's in respect to size.

Competition in grocery retailing

Major competitors to major supermarket chains in the fresh produce sector are:

Sydney: large specialty fruit and vegetable retailers (including chains)

Melbourne: markets (Queen Victoria, Preston, South Melbourne, Prahran)

In addition, competitors include the small fruit and vegetable retailers and independent supermarkets throughout the country.

Q.37 Is the Australian grocery industry of a sufficient size to sustain a third supermarket chain of similar size to Coles and Woolworths?

It is APAL's view that it is doubtful that the Australian grocery industry could sustain a third supermarket chain the size of Coles and Woolworths. The performance of Coles supermarkets in recent times would suggest that a third chain of similar size would create difficulties for one or all participants in the sector. It is almost certain that growers/producers would suffer greater pressure on prices as chains aim to win customers on price and so increase their market share. This might be good for consumers in the short term but you can only squeeze suppliers for efficiency gains and lower prices for so long until they decide to exit the industry due to unsustainability or lack of fair reward – there is already evidence of this occurring in the apple and pear industry.

Buying Power in grocery supply markets

Q.46 Are large grocery wholesalers or retailers able to acquire products from suppliers at lower prices or on better terms than smaller wholesalers or retailers? Does this differ by product type?

Large fresh produce wholesalers/retailers are able to acquire products from suppliers (particularly small suppliers) at lower prices/better terms due to market power. Sellers are forced to accept terms/prices at lower than preferred levels due to lack of alternative outlets for volume. Larger suppliers are better able to exert more influence as generally they will have better information about the supply/demand situation allowing true market forces to set prices. Larger suppliers not only sell the item consumed but provide services such as information, promotion and training for retailers' staff.

Q.47 Do grocery wholesalers or retailers with buying power pass on the lower prices they can achieve from suppliers to retailers and consumers?

Lower prices are not always passed on to consumers – supermarket chains often extract better margins for themselves. For example, some varieties like Granny Smith attract a lower wholesale price but there is little difference at retail level. On other occasions they do benefit consumers when catalogue specials are offered. Supermarkets generally apply a 2.5% settlement discount to all suppliers, this is not the case with other wholesalers.

Q.49 Do suppliers offer the same terms and conditions to all grocery wholesalers or retailers? For example, if a small wholesaler offered to purchase the same volume as a large wholesaler, would the small wholesaler receive the same volume discount?

Suppliers typically offer the same terms and conditions to all wholesalers or retailers. Volume discounts do not apply in the fresh produce trade as a rule as no individual supplier of apples or pears is big enough to influence a market to any extent.

Q.50 Is there evidence that large grocery wholesalers have market power as acquirers of products and what are its effects at the retail level?

Large fresh produce wholesalers/category managers do have market power over grower/producers when they capture exclusive access into supermarket chains. The wholesaler/retailer can capture and retain margins and unless these are fully transparent and justified by value added activities, growers/producers and consumers can be the losers. This is particularly so when a percentage mark-up is applied rather than a 'cost-plus-risk-plus-profit' basis. However the dominant market power is retained by the MSC's – the competitive nature of this sector is such that they do not allow even the wholesalers or category managers to exert market power.

Q.52 Are there other forms of behaviour or conduct by supermarkets in their dealings with producers or suppliers that may indicate market power?

Supermarkets request supplier compliance to provide price support to 'specials'. This is indicative of market power exerted by supermarkets due to their ability to move large volumes of product in a short timeframe. Supermarkets ability to change and set prices in accordance with their own profitability objectives is indicative of market power. Supply and demand factors do not always play a part in the 'specials' as advertising and timing thereof is booked well in advance of market intelligence, and decisions are made without the involvement of the supplier. It is acknowledged that MSC's generally cut their margins to deliver the 'specials', however it is likely that this is offset by the increased turnover generated.

Q.53 How could grocery wholesalers or retailers exercise any market power? Could major retailers credibly threaten to 'delist' a product or brand? How would consumers react if their desired brands are not available at their local supermarket? How important is the potential for a grocery retailer to substitute to a private-label or generic brand? Do major retailers threaten to import products in preference to local brands and how credible is the threat? What options do suppliers have if this occurs? Where else could suppliers sell their products (other grocery retailers, exports)? What are the consequences at the retail level?

Supermarkets openly support Australian grown produce except when it cannot be sourced in Australia. In fact they openly refrain from the suggestion that they would stock imported product. However, it is believed that in closed-door negotiations with local sellers they use international commodity prices to push down the price of locally sourced product (and no account is taken of the possible reduced quality and food safety issues for consumers).

Competitive position of small and independent grocery retailers

Q.56 Are the wholesale prices independent and small retailers pay affected by the wholesale prices the MSCs pay? For instance, if a MSC puts pressure on a supplier to lower its prices will the supplier:

- *attempt to 'make this up' by charging more to other wholesalers and retailers, or*
- *reduce the prices it charges other wholesalers and retailers so other wholesalers and retailers can remain competitive with the MSCs?*

Wholesale prices paid by independent and small retailers may be affected by the wholesale prices paid by MSC's. Because of the reliance on the MSC's to move volume if they apply pressure on suppliers to lower prices, growers will almost certainly comply (subject to stock and current market circumstances). Suppliers have no ability to 'make this up' by charging more to other wholesalers and unless market forces dictated, would not purposely reduce prices for other wholesalers and retailers to enable them to remain competitive with the MSC's. Market demand and grower offers dictate the price paid.

Factors influencing pricing of inputs along the supply chain

Q.66 What are the major influences on the prices you receive for your produce? How are your prices determined? What proportion of the retail price of the product do you receive?

Prices received by producers are fundamentally driven by supply/demand factors, however information is far from perfect and often prices are set by the weakest seller who generally has the poorest information. The volume of specific varieties of apples and pears at a given point in time is the ultimate determinant of price as demand remains fairly constant within normal seasonal fluctuations. The price setting process, which is related to competitive demand at the time, occurs on the wholesale market floor, and these processes provide the basis for price negotiation with MSC's. Producers of apples & pears typically receive around 50 per cent of the retail price although this can be lower depending on wholesale commissions and promotion contributions demanded by MSC's. Prices are based on an offer system by grower/packers/marketers based on the view of current supply and demand. It is also influenced by 'specials' that have been pre-booked by the MSC. Not all grower/packers/marketers have an intricate knowledge of the market influences therefore leading to pricing being set by weakest or least knowledgeable seller.

Q.67 Have the prices you receive for your produce changed over the past 1 to 3 years? What have been the major reasons for any changes in the prices you receive? Have your costs of production changed over the past 1 to 3 years? Have the prices you receive for your produce changed by more or less than your cost of production? Please provide details?

Prices received by growers/producers fluctuates from season to season and within seasons, driven by supply and demand factors for market grade product. However over the last three years, prices have remained relatively stable (aside from the seasonal fluctuations). Costs of most inputs have increased across the industry however productivity gains (where achieved) have more than offset the cost of production. Additional costs that have been imposed on growers/producers over the last three years relate to tougher specifications and additional policing of QA requirements. This has been of benefit to consumers and reduces the cost of waste as well.

Q.68 To whom do you sell your produce? What supply arrangements do you have with the buyers of your produce? Do you sell any of your produce to the MSCs? If so, what options do you have if you decided not to sell to the MSCs (other grocery retailers or wholesalers, food processors, exports, etc?)

Apple & pear growers/producers mostly sell to a range of buyers, including through the MSC's and the wholesale markets. Supply arrangements to the MSC's are dictated by defined channels and preferred supplier status. To maintain this status suppliers need to provide consistent quality and volume, although long-term commitments are not typically locked in. In the absence of supply direct through MSC's suppliers can sell through the wholesale markets or export.

Q.69 If a MSC put pressure on you to lower your prices would you attempt to 'make this up' by charging more to other wholesalers and retailers, or would you also lower your prices to other wholesalers and retailers so they can remain competitive in grocery wholesaling and retailing?

If a MSC pressured prices lower, suppliers could not look to charge more to other outlets to 'make up the difference'. Supply and demand factors will generally determine the pricing, although good information is not always widely known, which can distort pricing outcomes.

Impediments to efficient pricing of inputs along the supply chain

Q.73 Is there evidence of market power in the supply of grocery products to retailers or wholesalers? Please identify specifically which grocery products and explain the sources of market power?

Market power exerted by MSC's can be observed when excessive margins are extracted from consumers at the expense of lower prices (and usually higher consumption) – see comments under 'Grocery Retailing'. MSC's also pressure preferred suppliers to maintain confidentiality about pricing (an example of reduced price transparency).

Q.74 Are there any impediments to cost savings flowing through the supply chain to consumers?

Retailers tend to maintain 'standard' pricing levels for apples/pears which don't necessarily reflect costs. Retail margins have increased over the last three years and costs to consumers have increased despite productivity gains. (Producers have not necessarily received more for product over the same period).

Q.75 What are the consequences for suppliers of any market power of grocery wholesalers or retailers in the acquisition of grocery products (e.g. lower prices to suppliers, transfer of risk and/or costs to suppliers, decreased incentive for investment and innovation along the grocery supply chain, etc.)?

The market power exerted by wholesalers and MSC's in the acquisition of fresh produce means that price risk is generally carried by the supplier and additional costs are always borne by the growers/producers (eg additional QA testing costs) and this reduces the incentive for innovation and investment in productivity gains. However there are occasions when the MSC's do 'lock-in' prices and volumes with suppliers by negotiation and therefore carry some risk.

Q.76 What are the potential consequences of suppliers having any market power along the grocery supply chain?

If suppliers had market power, this could ultimately lead to higher prices for consumers, although the transfer of market power doesn't occur unless there is a natural disaster which dramatically diminishes supply. Market manipulation generally does not occur due to the high number of grower/ producers and their relative size.

Q.77 Has the degree of vertical integration in the supply chain had an effect on the pricing of inputs? If so, in what way?

Vertical integration in the supply chain has not noticeably impacted on the price of inputs.

Q.78 What impact, if any, does the presence of direct supply agreements have on the level of competition in the markets for those individual products?

Direct supply agreements have not reduced the level of competition. However they have imposed access restrictions and additional costs in some cases on smaller suppliers who are unable to enjoy direct access arrangements. In the case of the MSC suppliers the direct supply agreements have increased competition between participants.

Q.79 How has the sale of private-label or generic products by grocery retailers changed in recent times? Has this change had any impact on the level of competition along the grocery supply chain?

Loose sales of apple and pears have not yet been impacted by 'private-label' and 'generic' retailing. However pre-packed items are required in special packaging, which limits the ability of the grower/packers to sell to another segment of the market without incurring additional costs of repacking. This leads to pressures to sell at a reduced price to meet a competitors price or to assist in stock clearance due to slow demand as the costs of repacking and transport exceed the price reduction. This is also the case of fresh produce loose packed in MSC imposed packaging, for example Coles plastic crates. Grower/packers can sometimes be in a 'take-it-or-lose-even-more-money' situation by changes in demand which have resulted in over ordering by the MSC.

Q.80 Do the pricing arrangements, terms and conditions of supply, or contracts between suppliers and wholesalers/retailers limit the degree to which suppliers can pass on cost savings or cost increases?

The price setting process between suppliers and wholesaler/retailers is determined by supply/demand factors and therefore there is virtually no opportunity to pass on cost savings or cost increases in the short term.

Horticulture Code of conduct

Q.81 What has been the impact (if any) of the Code on market behaviour along the supply chain for horticultural products?

The impact of the code on the apple/pear industry has been minimal up to date. Merchant/Agent agreements have not been widely adopted and many of these have been non-compliant with the Code. There has been a widespread view that the Code will not achieve its objectives unless compliance is enforced. In the early stages many growers were encouraged by merchants to sign back dated contracts to avoid the code and since its introduction Agent marketing arrangements have been very difficult to find.

The industry view is that the Code in its present form does not deliver the balance of market power that growers envisaged, albeit limited to transparency and clarity of price and contract terms, the status of the buyer and the ownership and risk of the product. However, ironically and more fundamental for the success of the Code, growers believe it may be delivering terms that are 'transparently and clearly' unfair which is a disincentive for growers to persist in negotiating their rights under the Code. This disincentive can only be overcome through enforcement of the Code by the ACCC.

Q.82 What would be the impact on market behaviour along the supply chain for horticultural products if retailers and other major buyers were also included in the Code?

While the MSC's offer a substantially greater degree of transparency in the pricing and supply arrangements to growers they still do not provide written contracts – only 'growing agreements'. Therefore growers cannot be certain about their marketing outcomes and still must negotiate price and supply arrangements on a weekly basis.

Q.83 Would such inclusion improve the effectiveness of the Code?

There is a strong argument that the Code should cover all sectors of the supply chain and that transaction transparency be the primary requirement regardless of the 'path to market'. Until this outcome is achieved consumers and growers are likely to be realising a suboptimal result. The inclusion of MSC's and other major retail buyers under the Code would only improve its effectiveness if other major issues are also resolved (including the enforcement of compliance).

APPENDIX

Background to APAL

Apple & Pear Australia Limited (APAL) is the peak industry body representing the interests of commercial apple and pear growers/producers in Australia in matters of national importance including regulation and legislation, marketing, research and development.

It has a key influence on the direction of research and development and the marketing and promotions strategies designed to advance the Australian apple and pear industry, domestically and internationally. These activities are funded through levies paid by each apple and pear grower/producer in Australia. The funds and many of the activities are administered through Horticulture Australia Limited in close association with APAL.

APAL also represents the industry on agri-political issues, including campaigning to protect the Australian pome fruit industry against quarantine risks posed by unsafe imports.

In addition, APAL manages a number of trademarks internationally on a commercial basis - most notably the **Pink Lady™** and **Sundowner™** trademarks, which allows growers worldwide to sell premium quality apples from the Cripps Pink and Cripps Red apple varieties at a premium price.

Industry background

Apples and pears are grown in all six Australian states, (not in the Northern Territory). The major apple and pear producing areas are Stanthorpe in Southern Queensland, Orange and Batlow in New South Wales, the Goulburn Valley in Victoria and Southern Victoria, Huon Valley in Tasmania, Adelaide Hills in South Australia and the Perth Hills, Donnybrook and Manjimup regions in Western Australia. In addition, there are many small pockets of apple and pear production in each state.

Victoria is Australia's largest producer of apples and pears, generally producing more than 30 per cent of the nation's apples and close to 90 per cent of the nation's pears - mostly from the Goulburn Valley area around Shepparton. New South Wales and Western Australia are the next largest apple producing states.

The main apple varieties grown traditionally have been Red Delicious and Granny Smith (55 per cent of production in 1998/99). However, newer varieties such as Gala, Fuji, Cripps Pink (which may be sold using the trademark brand name Pink Lady™) and Cripps Red (which may be sold using the trademark brand name Sundowner™) now account for more than 40 per cent of production.

Apple and pear exports have declined in recent years due to global pricing pressures however there remains a focus on the premium markets for Pink Lady™ in the UK as well as other opportunities for a range of varieties in Sub-Continental Asia.

Australia, in relation to other Apple and Pear producing countries, represents around 0.8 per cent of world production of apples and 1.4 per cent of world pear production.

The spread of apple producers around Australia provides consumers with an excellent range of high quality product year in, year out. The dispersed nature of production reduces the risk of supply volumes and quality being impacted by adverse weather events.

Apple and pear orchards in Australia are still dominated by family run businesses and range in size at the smaller end of the scale from around 10 hectares up to the larger enterprises in excess of 200 hectares. Approximately 1300 farms are engaged in commercial apple and pear production and as is common right across agriculture 20 per cent of the businesses produce 80 per cent of the product. Cooperative packing and marketing businesses exist in three important growing regions – Batlow, Lenswood and Orange. Other areas rely on large commercial packing/marketing businesses and individual packing operations on orchards. Some enterprises are vertically integrated to varying degrees, some involved at the input level in producing nursery trees while others extend into commercial packing and marketing and supermarket category management operations.

Grower/producers and packers have made significant improvements in quality assurance systems to support traceability of product from retailer back to the farm gate. Coupled with the integrated pest management systems widely employed within orchards and the strict management over maximum residue limits for agrichemicals consumers are now enjoying apples and pears of higher quality and with greater assurance of food safety issues than ever before. Grower/producers have also necessarily responded to changes in OH & S and environmental issues. These changes have been driven on both a legislative viewpoint and change in community expectations. APAL has sponsored through its Future Orchards 2012 a drive to increase on farm productivity via the adoption of intensive orchards systems and more efficient production.

Supply chain components of Apple and Pear industry

1. Grower/Producer – grows fruit ready for human consumption. Refrigerated storage usually on site. Is in compliance with food safety specifications.
2. Packer – prepares fruit for retail sale. Sizes, washes & polishes, labels and is in compliance with quality specifications
3. Category Manager - acts as the interface to supermarkets both large and small. There is little opportunity to interact with supermarkets without a category manager although some supermarkets purchase a portion of their offering from the wholesale markets.

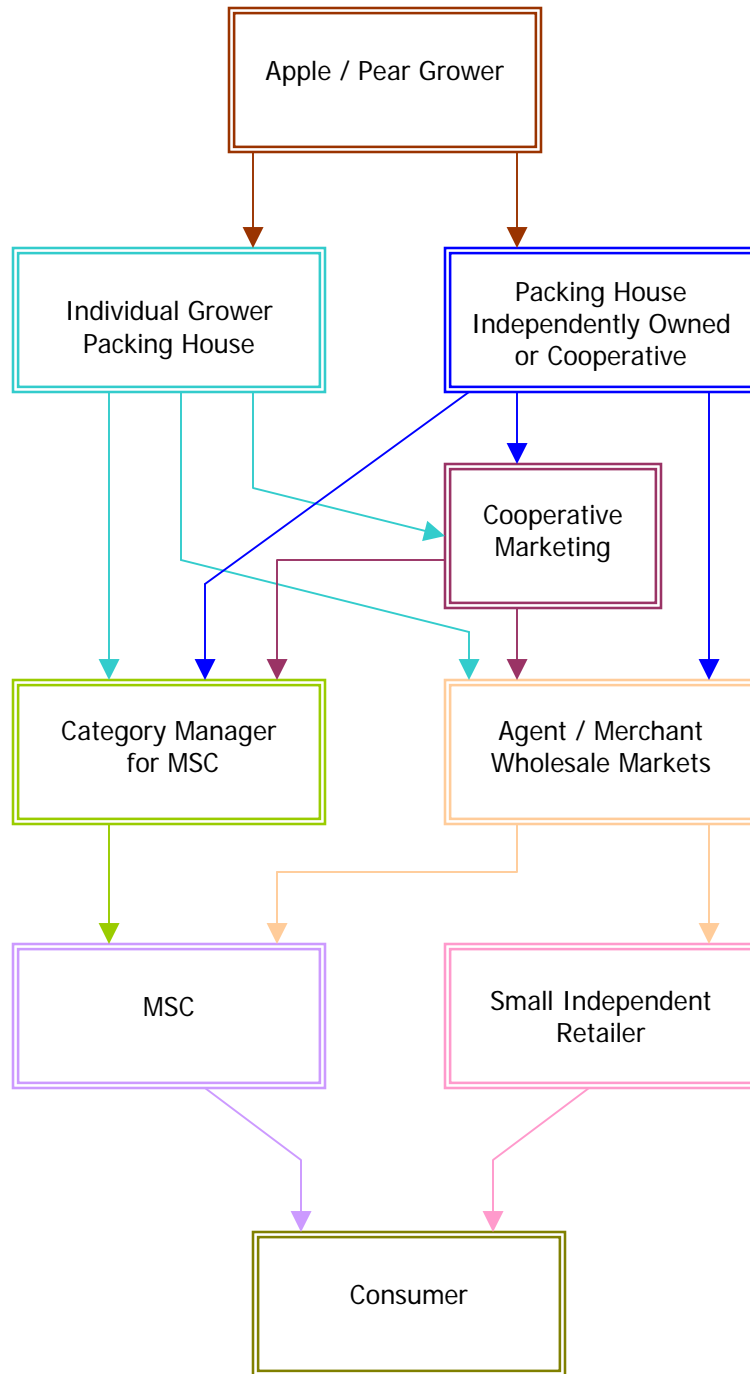
1 and 2 and 3 can be fully integrated. 1 and 2 or 2 and 3 can be combined or each of the above components can be separate units.

4. Wholesale distribution eg MSC distribution centres, Central markets. A wholesaler in the central markets can also be a category manager (level 3 above)
5. Retailers – chains and independents

Consumers generally purchase from level 5. There is some opportunity to purchase at level 1 on farm sales or at farmers markets. There is also some limited opportunity to purchase at level 2 and at level 4.

Each level is a cost centre (even the distribution centres and store levels) and is a margin centre. Little is known about the costs or margins by other levels.

Supply Chain Diagram *



* Represents the majority of product flow