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Horticulture Australia Ltd

Public Submission to ACCC Grocery Inquiry by Horticulture Australia Ltd on 11th March 2008

prepared by

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1. Executive Summary

In its capacity as a centre of knowledge for horticulture, Horticulture Australia Limited (HAL) is making this submission in order to provide the ACCC with an objective and accurate picture of the supply and pricing of fruit and vegetables through the retail supply chain and other chains including foodservice and processing.

HAL has an annual expenditure of $80 million in projects in partnership with the horticultural sector and governments.

HAL manages greater than 1,200 projects annually across a wide diversity of topics as a core part of their mission, to invest in programs that provide benefit to Australian horticultural industries and the producers (Growers) whose levies provide the core of the funding for HAL activities.

In considering the price of food through the retail grocery channel is it imperative that the ACCC is given the opportunity to understand that the fruit and vegetable supply chain is uniquely different from all other sectors of the grocery supply chain. Fruit and vegetables is a significant component of the fresh food offer in Major Supermarket (MSC), Other Supermarket Chains, Independent Greengrocers and numerous other, small in number yet unique, outlets such as local markets and farmers markets. However, even compared to other fresh food chains, such as meat, dairy and delicatessen, the fruit and vegetable chain is extremely different.

The core objectives of this submission are:

1. To provide the ACCC with a detailed understanding of the Australian horticultural value chain from producers (Growers) to consumers.

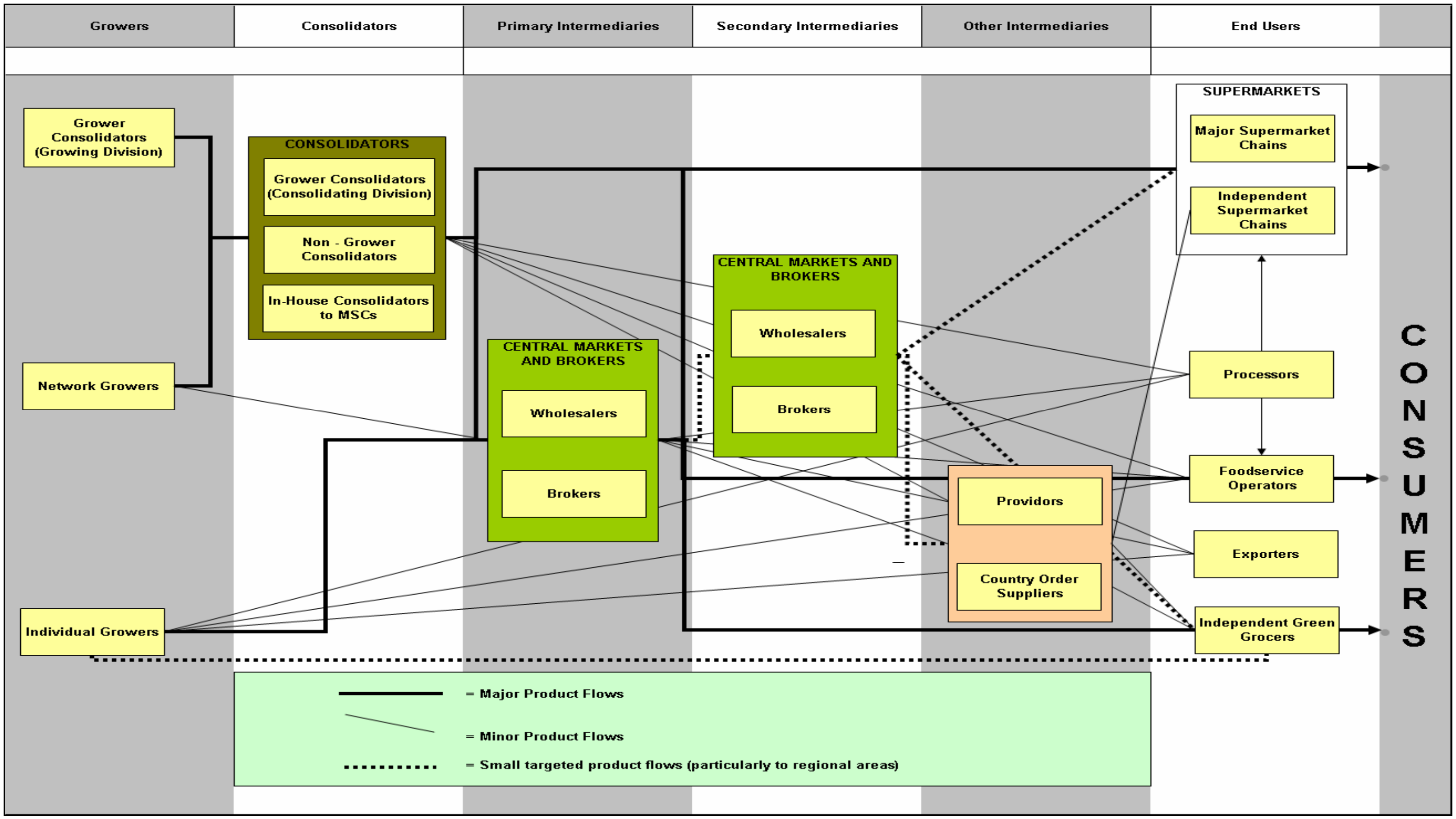
2. To provide the ACCC with a description of the major factors that impact on the economic health of Australian horticultural producers (herein referred to as Growers).

3. To provide the ACCC with a detailed understanding of the important role that horticulture makes to many regional economies and the national economy as a whole.

4. To provide recommendations to the ACCC where information gaps exist on a methodology to address these gaps during the term of the enquiry.

The supply chain that operates to deliver fruit and vegetables to End Users (including Retailers) and then consumers across Australia is illustrated in Figure 1.

Figure 1: Current Australian Horticultural Supply Chain Structure



Source: CDI Pinnacle Management, 2008.

Within the body of this submission, more simplified and specific diagrams are provided that describe by illustration the specific structure of the supply chain between Growers and each of the major categories of grocery Retailers, being Major Supermarket Chains (MSC), Other Supermarket Chains and Independent Greengrocers and also for Food Processing and Foodservice.

The fresh fruit and vegetable supply chain is best considered in four parts being Retailers, Consolidators, Mid-Chain and Growers.

1.1 Recommendation to Assist the ACCC Inquiry

As has been referred to in other sections of this executive summary and discussed in detail throughout this submission, the time available to undertake the research that supports this submission was not adequate to investigate this complex supply chain, the costs, prices and margins being experienced at each level in the chain, and the issues of most concern to the fruit and vegetable Growers and other chain participants. Further HAL frankly does not believe it is possible to undertake such an activity without the willing participation of Growers, Consolidators, Mid-Chain and Retailers (MSC', Other Supermarket Chains and Independent Greengrocers). The results of the investigation we believe should be made publicly available, although the identity of contributing parties should be subject to confidentiality.

As has been noted by HAL, the ACCC were able to reach definitive conclusions on margins in the supply chain in the red meat industry through the "Examination of the prices paid to farmers for livestock and the prices paid by Australian consumers for red meat". We (HAL) wish to offer our assistance in the conduct of detailed study during the course of this enquiry.

HAL's suggested approach is that an independent party be commissioned by the ACCC to conduct the investigation with its Terms of Reference agreed to by a Steering Committee of parties which the ACCC who decide should be invited. The enquiry should focus around a basket of horticultural products which exhibit a variation of characteristics (staple, non-staple, perishable, non-perishable, imported, exotic for example). HAL believes the results of the investigation should be made publicly available although the identity of contributing parties should be subject to confidentiality.

HAL strongly suggests that if such an approach is pursued that parties who are viewed as having a position of trust within the industry be retained in order to ensure that the contributing parties are satisfied that commerciality and anonymity will be preserved.

1.2 Retailers

1.2.1 MAJOR SUPERMARKET CHAINS (MSC)

Coles and Woolworths together are estimated to account for 60-65 per cent of all fruit and retail vegetable sales to consumers in Australia. The total number of stores operated by these two MSC in 2007 was 1,493, an increase of 11 per cent over the number in existence in 2003.

Whilst there is only two companies controlling this sector the competition between them at national and store level is intense. Currently the fresh produce section is considered to be the major point of differentiation between the MSC Retailers. Fresh produce is also reported to be delivering the highest gross margin of any category in the supermarket.

Key drivers of change in MSC fresh produce retailing include increased variety, new and innovative packaging and pack formats, year round supply, food safety and integrity, stock management (and wastage control), cost control, and rationalization in the number of suppliers delivering to each of these chains.

Whilst the percentage of supply sourced from each type of supplier has not been able to quantified in the time available for this submission, MSC source from three types of types of suppliers; Consolidators (Grower and Non-Grower), Individual Growers and Central Markets (Wholesalers).

The drive to reduce the number of suppliers is very real. Coles had 800 fresh produce suppliers 2 1/2 years ago, has 450 currently and has stated its intention to further reduce the number to approximately 250 in the next two years. Woolworths is reported to be pursuing very similar objectives in terms of end numbers of approved suppliers.

Both MSC operate Approved or Preferred Supplier programs. Approved suppliers can be Consolidators, Wholesalers and Individual Growers and must satisfy a set of criteria set out in Section 6.3.2. Whilst press releases and industry news suggest that Growers are concerned about the market power of MSC, discussions as part of this submission with numerous Growers and Consolidators that are preferred suppliers to MSC indicate they are quite satisfied with their relationships with MSC.

Of significance to the way the MSC supply chain operates today is the role played by Consolidators (Grower Consolidators and Non-Grower Consolidators), a chain function that did not really exist 10 years ago. A large proportion of produce supplied to MSC today is supplied directly to Retailers by Consolidators. The role and nature of Consolidators is discussed in some detail in Section 4.2.

Coles and Woolworths compete vigorously in the fresh produce department, understandable given that it is seen as a major point of differentiation and is a significant bottom line contributor to the store. Whilst the two chains appear similar in many ways in their approach to fresh produce, they do differ substantially in the methods they employ to source, range and market produce on a daily and weekly basis. A rebate and, where applicable, cooperative marketing levy is also commonly charged by MSC. MSC also commonly charge a distribution fee when the product is routed through the MSC distribution centre (the majority of lines).

An example included in Section 1.6 and Section 6.7 outlines the nature of these charges.

MSC expect their produce managers in store to achieve gross margins in the range of 32-37 per cent. The gross margin percentage varies between product lines contingent on several key factors including historic wastage levels per line, perceived risk and or perishability of lines, competitiveness of the line (some product lines are subject to aggressive price buying by consumers), and shelf life of the product. The MSC collectively have introduced major chain re-engineering initiatives in recent years that have significantly changed the logistics and handling model and created significant set up cost, which has been in the main passed on to other supply chain participants. In particular this refers to the introduction of Returnable Plastic Crates (RPCs, Coles) and the One-Touch packaging initiative (One-Touch, Woolworths).

Frequently the media appears to play a role which seeks to generate a situation of ‘us and them’ between Retailers and the rest of the supply chain, which HAL consider not to be of advantage to anyone. HAL concludes that whilst it is not be possible to prevent ‘sensational journalism’ the whole supply chain needs to be able to be presented with accurate, comprehensive and independently verified information costs and margins from Grower to End User. Presently this type of information is not available, with anecdotal, single party discussions only being used to reach general conclusions (and indeed to collate much of this submission in the time available).

1.2.2 INDEPENDENT RETAILERS / SUPERMARKETS

There is an estimated 4,700 of Independent Retailers / Supermarkets in Australia in 2007. This number includes IGA / Metcash / Spa with 2,300, Foodworks with 660, ALDI with 120, Pick n Pack with 70 and an estimated 1,500 unbranded / independently run stores. This total number has increased by an estimated 2,600 stores since 2003.

Independent Supermarkets are seen by some as being less advanced than MSC in direct sourcing from Consolidators and Growers. Independent Supermarkets have significant reliance on Wholesalers, particularly in Central Markets for their supplies of fresh produce. They also are seen to have less focus generally on fresh produce (exceptions being found in rural and regional areas).

The advent of ALDI in the Australian market has had significant impact, particularly interesting given that Australia is the only country where ALDI has entered the market for fresh fruit and vegetables. The ALDI model is unique, they only source 25– 30 produce lines and aim to source and market produce that is not premium priced, aiming for mid market positioning in this area.

Anecdotal evidence collected for this submission suggests that Independent Supermarkets aim for gross margins in fresh fruit and vegetables of 35-45 per cent. These higher margins are reported to be necessary to allow for higher wastage than their MSC competitors. IGA and Foodworks are also thought to carry larger overheads than ALDI and the other Independent Supermarkets.

1.2.3 INDEPENDENT GREENGROCERS

In 2002 there were an estimated 1,600 Independent Greengrocers across Australia. Accurate numbers in 2007 have not been able to be collated in time for this submission, although the total number appears to have changed little in the intervening period.

The Independent Greengrocer sector is today competing effectively with the MSC and as reported by sector sources professionally run stores that are well located are producing sound profits. There is consensus amongst the industry that the Independent Greengrocers are seen to be stronger than MSC in areas including presentation, waste management, accessing and selling high quality produce with good shelf life, lower labour costs and management overheads and are price competitive for comparable quality produce.

Greengrocers providing input to this submission indicate that they pursue gross margins in the vicinity of 35 per cent on sale price however gross margins vary greatly between product lines. Good control over waste, low labour and overhead costs and significant skills in ranging for their local markets enables them to generate sound store profitability.

Sources did indicate however that for both MSC and Independent Greengrocers there is a general departure away from using gross margin targets to assess the profitability of lines. This is due to the higher average prices that are being paid for fruit and vegetables in general. The untested view in respect of the higher prices being currently is due to the combined impacts of drought (and more importantly water availability) and recent rainfall events in certain areas of Australia.

It is also suggested by industry sources that MSC have strengths compared to the Independent Greengrocers in areas including direct purchasing from Consolidators and Growers, re-engineering for cost economies and efficiency (eg. RPCs, One-Touch), and freight costs through buying power.

1.3 Consolidators and Their Networks

Largely, consolidation networks have been pro-actively or subtlety developed as MSC actively continue to reduce their supplier numbers and / or forward-thinking larger Growers (and Wholesalers) recognised an opportunity to create larger commercial enterprises.

Consolidators fall into two categories presently. These are:

1. Grower Consolidators: Are Consolidators who grow produce in their own right, but who also co-ordinate / direct other Growers to supply them. Grower Consolidators are the company who has the relationship with the Wholesaler / Retailer / Exporter.

2. Non-Grower Consolidators: Are Consolidators who do not grow produce but who work closely with a limited number of suppliers to develop programs for the Retailers or Processors. Growers may or may not participate actively in the relationship between the Non-Grower Consolidator and MSC or Processor. In many instances this type of Consolidator is either a current or former market wholesaler. Non-Grower Consolidators are responsible for all activities associated with the relationship except the growing, packaging and in some instances the movement of the product.

3. A third type of Consolidator was in existence until recently, that being the In-house Consolidator. In-House Consolidators had a contractual relationship with a MSC to acquire a 'basket of goods' on their behalf for which they are paid a fee. The In-House Consolidator worked on behalf of the MSC and so their first loyalty was to minimise the acquisition cost to their customers. As of early 2008 these operations are reported to be ceasing.

1.4 Mid-Chain

The most strident concerns of parties providing input for this submission have been in regard to concerns expressed about the levels of transparency and the possible inappropriate use of market power by some Wholesalers in the Mid-Chain, particularly as it relates to impacts on smaller, less informed Growers. This concern is in regard to Wholesalers who do not appear to be willing or able to change their business model to accommodate the intent of the recently introduced mandatory Horticultural Code Industry of Conduct (HCIC).

Parties in the Mid-Chain, predominantly Wholesalers and Brokers, use a number of transaction models and pricing models. There are reported to be four formally recognized models being agency, merchant, Broker or agreed price and one that has been 'coined' by some in the Grower sector as "pseudo agency".

The area of concern, expressed in the main by Growers, their industry organizations and advocates, is where the merchant model is used (and some would say the pseudo agency model) where there is no requirement for the merchant to inform the Grower (his supplier) of the price he achieved for the produce when it was on-sold or the identity of the buyer of the Growers produce.

There are 370 primary Wholesalers located in the Central Markets in capital cities across Australia. The relationship between Wholesalers and Growers has been a source of contention, innuendo and expressed dissatisfaction historically. The HCIC was introduced in early 2007 in an attempt to address this issue in the fruit and vegetable supply chain.

Growers (suppliers) who are impacted by the improper use of market power can:

- potentially receive less than an equitable share of the profits generated in the chain,
- be at risk of not being able to pass on increases in cost of production and supply (inequitable transfer of risk),

- be at a disadvantage due to their inability to receive accurate market signals and open feedback / communication from the rest of the chain
- be discouraged from investing in developing new technologies for their business and discouraged from investing in enhancing their knowledge and skill sets, to better perform as chain participants

Initial research suggests the area of the chain where this may be most likely to occur is where product is initially transacted from Grower to Wholesaler on less favourable transaction terms (eg. merchant or "pseudo agent" basis).

The nature of the parties and the factors that lead to the perceived imbalance in market power between Growers and Wholesalers is discussed in some detail in the course of this submission.

1.5 Growers

HAL believes there are currently 18,800 Growers of horticultural products in Australia that collectively employ 80,200 people, representing 20 per cent of the total employment in agriculture.

The horticultural production sector has changed significantly over the past 10 years. The advent of and continuing dominance of the MSC in the retailing of fresh fruit and vegetables has had a marked impact on the structure of the sector and the role of producers.

Traditionally and up until approximately 10 years ago, almost all fruit and vegetable Growers sold their produce to a wholesaler that was most often located in a Central Market in one of Australia's capital cities or in a small number of then operational regional markets.

Today fruit and vegetable Growers can be regarded as belonging to one or more of three categories of Growers, being:

1. Grower Consolidators.
2. Network Growers.
3. Individual Growers.

With an estimated 60-65 per cent of fresh fruit and vegetables being purchased and sold by MSC, the Grower numbers have declined while some, in particular those that now act as Grower Consolidators, have grown substantially. Family owned Growers that both produce themselves and also consolidate products from their network Growers exist with sales turnovers well in excess of $40 million.

The percentages of fruit and vegetables that MSC buy direct from Consolidators is hard to accurately report however some recent research referenced herein suggested it is in excess of 40 per cent. Anecdotal evidence from some Consolidators suggests it may even be higher than this figure.

Clearly the determined strategies of the MSC to reduce the number of suppliers of fruit and vegetables will continue to favour the role of Consolidators and enhance the access and opportunities for their network Growers. As is outlined in some detail herein, in order to sustain their role in the chain the individual Growers that choose not to join Consolidator networks are going to find it necessary to be informed, focused and capable of producing high quality products consistently as well as developing and maintaining their unique strengths as specialist suppliers.

As has been discussed in other sections of this executive summary and in detail in numerous sections of the report, the issues that concern Growers and their advocates include but are not limited to:

1. The resolution of the Mid-Chain concerns over the perceived lack of transparency and the inappropriate wielding of market power by some Wholesalers.

2. The increasing costs of production, packaging and compliance (regulatory and chain related) and their lack of ability to pass these cost increases on, ultimately to consumers.

3. Access to labour and the ability to compete with other sectors (eg. mining) for the labour that is available in regional areas.

1.6 Summary Responses to Selected ACCC Issues

The body of this submission provides the ACCC with detailed information and understanding of the supply chain for fruit and vegetables (in particular fresh fruit and vegetables) to the various different types of grocery Retailers and addresses key issues and concerns that industry participants and organisations have enunciated in their input to this submission. The body of the report also provides "in context" responses and discussion that directly responds to the ACCC issues that are specifically pertinent to the fruit and vegetable supply chain.

Additionally, in Table 1 provides a Summary Response to these key issues to assist readers to familiarise themselves with the content and perceptions gained from industry, prior to absorbing the greater detail in the body of the submission. These summary responses are also cross-referenced to the specific section where more detailed discussion has been submitted.

Table 1: Summary Responses to Selected ACCC Inquiry Issues

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
[1]	What have been the major causes of rising food prices in Australia (eg. 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?	▪ Cost of labour on farms and in packing facilities has increased by a minimum of 27.5 per cent in the last five years. Competition for labour in regional areas between industries, in particular impact of mining, has seen rates in many areas increase at an even greater rate. Labour costs depending on the crop account for around 30 per cent of farm and transport costs. ▪ Cost and availability of water, both of which impact cost directly and indirectly and impact volumes produced, thus increasing competition for produce when lack of water increases demand verses supply. Access to water in some production zones has increased more than $1,000 per megalitre. ▪ Compliance costs including regulatory and commercial compliance costs required through-chain (eg. quality systems, RPCs, retail-ready programs) are impacting Growers, Consolidators and Wholesalers, as Retailers seek to push responsibility and costs down the chain. ▪ Persistent drought and widespread floods both impact production costs and also availability of produce, which increases the imbalance demand / supply imbalance. ▪ Packaging costs (effectively pushed down the chain by Retailers) including CPI increases in standard packaging and new consumer demand patterns requiring new levels of packaging inputs (eg. guaranteed sweet, ripe and ready and others) are impacting Growers, Consolidators and also Wholesalers / Processors that are value-adding (eg. pre-packing). Indicative evidence that suggests that RPCs have lowered per unit costs to farmers although the one-off costs of implementing new handling systems have caused Growers short term costs. ▪ Fuel and major farm inputs (eg. fertilisers, pesticides) have increased significantly, in particular fuel prices in recent years. The price of diesel in the last five years has increased 52 per cent. Freight costs on limited evidence have increased approximately 33.1 per cent. ▪ Non-produce inputs into wholesaling and retailing have increased substantially, for example pallet hire, bin hire, pallet wrapping have all increased according to Growers, although the rate of growth has not been evaluated. ▪ Temperature extremes can have major impacts on short-term supply volumes and losses on farms resulting in increased	Section 2.2, Section 4.4

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
		cost per unit output. ▪ Urban encroachment and the wider issue of increased value of arable land in recent years directly impacts price per unit produced, added to this current increases in interest rates will impact costs for larger more capital intensive Growers and Grower Consolidators. ▪ Time available for this submission does not enable deeper quantitative analysis of the impact of these matters and further research will enable greater clarity in key areas. Further, whilst it is obvious there has been considerable cost growth associated with the growing of fruit and vegetables this (limited) knowledge does not extend to the returns that Growers are receiving. Whilst there is strong anecdotal evidence that suggests that Growers are not being able to pass on cost increases, the lack of substantiative information in this area we see as a principal area / gap that needs to be addressed as part of this enquiry.	
[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?	▪ Inflation rates in the OECD countries as at March 2007 were comparable to Australia in general (World Fact Book, visited 7 March 2008). Under current (2008 and moving forward) global financial market conditions OECD countries are on the whole experiencing lower interest rates than those in Australia. ▪ This position deserves careful consideration in relation to the financial structuring of Consolidators, Wholesalers and Retailers in Australia compared to firms performing similar roles in other countries. The leveraging of Consolidators in particular in Australia deserves greater analysis than the time available for this submission permits, particularly given that many of these firms are family owned and financed and have experienced significant growth (which must be funded) in the last 5 to 10 years. Anecdotal evidence indicates strong leveraging particularly amongst the Consolidation sector. ▪ There are marked differences between Australia and the majority of OECD countries (particularly those OECD countries in and around the EU) in the areas of distance travelled from point of production to point of consumer sale, and in infrastructure and associated costs per head of population. This adds significant costs to the Australian supply chain. ▪ Time available for this submission has not enabled detailed analysis of the methodology and inclusions / exclusion in the calculation of CPI in all OECD countries compared to Australia. ▪ Impacts of drought, floods and adverse temperature and weather conditions in Australia can have a marked impact on fruit and vegetable prices (eg. Bananas in 2006) <u>both</u> in the production sector <u>and</u> also in the management of cool chain and thus	

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
		wastage through the chain, that may not be fully captured in the methodology used to calculate CPI, thus may deserve greater emphasis than currently included in CPI calculations. ▪ Market support measures for Growers in EU and USA economies may artificially impact on the CPI measurements if they are not taken into consideration in the calculation base.	
[3]	What have been the major changes to the structure of grocery retailing in Australia over the past 5 to 10 years?	▪ The market dominance of MSC have not abated in this period, however there appear to be minor consumer shifts which support viable independent well managed Greengrocers (albeit for a smaller proportion of the total market) where they satisfy consumer demands for quality, service, competitive prices and shopping experiences. ▪ Anecdotal evidence indicates that between MSC, other Retailers and Independent Greengrocers the market share split is approximately 55-60%:10-15%:10-15%. The figures are anecdotal as total supply figures are not known as well as sales figures from individual Greengrocers and some Independent Chains are not collected. ▪ Over the last five years the number of MSC has increased by approximately 10 per cent. The number of Independent Greengrocers whilst difficult to calculate show signs of being stable or slightly increasing. With the enormous banner restructuring of Independent Supermarkets it is very difficult to conclusively assess their market position, however anecdotal evidence suggests the development of banner Supermarkets as been at the expense of independent grocery operators commonly referred to as 'corner stores' or 'Ma' & Pa' operations. ▪ The introduction of ALDI into the Australian market and the strengthening of other Independent Supermarket Retailers (IGA, Foodworks, etc) in some areas of the market has introduced small and perhaps sustainable alternative points of purchase for consumers, provided these parties are able to continue their development.	Section 6, Section 8.
[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	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. The later points of this statement are very important. Without the ability to gain the trust of parties involved in the chain, particularly Growers and Mid-Chain there is limited likelihood that the parties will participate willing. The ability to provide confidentiality and anonymity will also be a critical factor in determining if the supply chain participates.	Section 6, Section 7, Section 8.

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
	on capital do grocery Retailers achieve? Has this changed over the past 5 to 10 years?	▪ Anecdotal evidence, predominantly through personal communications with key operatives in MSC Retailers and their direct suppliers, suggests that target net profit after all costs for fresh produce in MSC may be in the area of 15-16 per cent of sales. Time has not permitted a comparative analysis of this in comparison to margins achieved in other countries including key OECD countries that would provide meaningful comparatives (eg. UK, Germany, Netherlands, France). ▪ Operating margins for fruit and vegetables are higher in MSC than for the general grocery category. In effect, fresh produce supports greatly the financial performance of MSC. ▪ At the gross margin level, anecdotal evidence collected indicates MSC have target levels of 35 per cent, Independent Greengrocers vary greatly (on sample collected suggested 14-44 per cent) and Independent Supermarkets store gross margins are targeted in the range of 35- 45 per cent. ▪ Initial summary information collected suggests that store-wide net operating margins for Australian MSC (4-5 per cent of sales) is approximately equal to or a little lower than that achieved by UK Supermarket chains (general range of 4-6 per cent sales).	
[10]	What have been the major changes to the structure of grocery wholesaling in Australia over the past 5 to 10 years?	▪ Particularly in this the Mid-Chain area, the time available for this submission has not allowed for a thorough analysis of this, the most complex, area of the fruit and vegetable supply chain. A key recommendation of this submission is that a well scoped analysis of revenues, costs, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ The Wholesaling segment of the chain is the area with which the Growers and other chain participants and advocates have the most concern and in which key issues related to the imbalance of market power and transparency are considered to be significant by these parties. ▪ With the advent of Consolidators (Grower Consolidaors and Non-Grower Consolidators) in the last 10 years, the role of many Wholesalers has changed significantly. Today some Wholesalers have migrated their business to a Consolidator model (Non-Grower Consolidators) servicing MSC and other larger retail outlets / types, while others are having to focus their business on finding niches, servicing other more specialised Retailers and Foodservice operators. ▪ The total number of Wholesalers appears to have only declined marginally however the size of Individual Wholesalers has	Section 3, Section 5, Section 6.6.

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
		increased substantially (as they take on Consolidator roles). ▪ There are a number of major Non-Grower Consolidators including Moraitis Fresh, Perfection Fresh Produce, Costa Group and Favco who handle multiple products for supply to MSC and others. Each of those whilst still operating Wholesaler operations have considerable power in the supply of produce to end users. The concept of the Paradox of Power is discussed and is certainly something that MSC are concerned about hence why they have single suppliers for very few lines. ▪ Concerns outlined herein about the effectiveness of the mandatory Horticulture Code of Conduct as currently operating highlights the fact that Wholesalers are diverse in their modus operandi, some shifting to a compliant business model while others are believed to be resisting the forces of change that are meant to be supported by the mandatory code. ▪ Price discovery for both MSC and other end users who fresh fruit and vegetables remains directly dependant on, the price signals are provided by the Central Markets. Anecdotal evidence suggests over the previous 10-15 years that the increasing amount of direct purchasing of their requirements by MSC has resulted in higher levels of price volatility due to demand / supply imbalances resulting from a smaller End User purchasing pool. ▪ Horizontal business integration across the Wholesaling sector has occurred minimally with few examples of Wholesalers who have invested in similar business in other metropolitan markets. A number of Wholesalers have taken equity stakes in other Wholesalers in other Central Markets. There is strong evidence of regular communication between Wholesalers regarding market conditions. There is further strong anecdotal evidence of discussions amongst Wholesalers regarding the 'performance' of Individual Growers and Growers Consolidators products and pricing.	
[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	▪ The continued dominance of MSC in this period and their drive to achieve chain efficiency, long lines of consistent quality fruit, year round supply of all major product types (as demanded by consumers) and their adoption of global operating principals / best practice, category management, risk mitigation (pushing risks and costs down the chain) and other key operating principals has driven the advent of Consolidators (Grower and Non-Grower) and the rationalisation of the number suppliers to each MSC. ▪ The cost of compliance, both regulatory and through-chain (competitive and Retailer driven) has and will continue to drive the establishment of larger scale in the Consolidator level of the chain, enabling the amortisation of higher costs across larger volumes of throughput and increased scope of operations (beyond that of a traditional Grower or traditional	Section 5.

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
	these and other factors?	Wholesaler). ▪ Wholesalers and Non-Grower Consolidators who do not supply MSC remain highly dependant and therefore competitive in terms of supplying the non-MSC market segments (i.e. Greengrocers, Smaller Independent Chains). ▪ Horizontal integration is mainly due to Wholesalers wishing to increase the number of channels available for them to sell produce, in addition to spreading overhead costs across a wide sales base.	
[12]	In what ways (if any) do grocery wholesaling operations and arrangements differ by product categories? Please provide details.	▪ Within fruit and vegetable categories there is minimal difference in the way the chain works, other than the key difference between the most direct routes (direct from Consolidator to MSC / Retailer and/ or direct from Individual Growers to MSC / Retailer / others) and the flow of goods through the chain via the Mid-Chain (Wholesalers, Brokers, COSs etc) ▪ The key differences between these two routes through the chain are at last two fold being: **a)**. logistics and physical flow of products across often large distances and **b)**. the directness, transparency, and accuracy of pricing and other signals from retail back to the Grower. In general terms the product that flows through the Mid-Chain travels further and/or is handled by more sets of hands **and** information flow back through the chain to Growers is less effective (for example Growers seldom know where their product has been sold by a Wholesaler or at what price, when they engage in a merchant style transaction model with their Wholesaler (and many suggest that this is still the majority of transactions). ▪ Mid-Chain operaters (Wholesalers, Brokers, COS's, Providors) differ mainly in scale and focus, some remaining small and specialised while others adopt strategies such as becoming known as a core source of supply for many / all customers across a defined sub set of fruit and / or vegetable products. ▪ Greater differences exist between Wholesalers in the nature of their relationships and transaction types with Growers, an area of expressed serious concern for Growers and their advocates. Agency, Merchant, Broker, Agreed Price and "Pseudo Agency" transaction types have been discussed herein.	Section 5.
[13]	How important are economies of scale in grocery wholesaling? What are the sources of these economies of scale? Are economies of scale	▪ Economies of scale are of most significance for Consolidators, whilst improved scale assists all operators in the chain. ▪ For Non-Grower Consolidators the main source of economies of scale is their ability to amass / access large volumes of consistent quality produce from Growers who are effective as Network Growers. This then enables greater volumes of throughput through packing facilities, greater buying power for key inputs and consumables (eg. packaging, freight), and	Section 5.

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	primarily the result of lower transport costs, lower storage costs, better stock management or the ability to negotiate better deals with suppliers?	greater ability to deliver MSC and other Retailers what they require, in full, on time, every time. ▪ Beyond the 'cost' of fruits and vegetables, wages comprise over 60 per cent of the one Wholesaler investigated in the preparation of this submission. Where there is significant management overhead the ability to spread these costs across an even greater volume of product is the obvious aim of all Wholesalers but particularly that of Non-Grower Consolidators. ▪ Wages as a percentage of sales for the one Wholesaler investigated remained constant when figures were compared across 5 years. ▪ Whilst in absolute terms additional economies which may be incurred by having greater volumes of product going through their businesses are comparatively small, they are nevertheless important for Wholesalers. ▪ Transporters do provide Wholesalers with better freight rates depending on volume but due to the low margins currently being achieved in that industry the variations are small. ▪ Further, the greater skill-set of Consolidators (compared to traditional Growers and traditional Wholesalers) enables them to negotiate and communicate with MSC and other Retailers more effectively, delivering key elements of what they require in Preferred / Approved Suppliers.	
[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?	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ Mid-Chain margins are not well understood at the point of making this submission, also they are the subject of rumours about excess margins being achieved through 'manipulation' of Grower returns. One large East Coast Wholesaler figures indicate that over the past 5 years that whilst their total revenue has increased by 65.7 per cent, at the same time costs have increased by 73 per cent. For this business net profit before tax represented 1.75% of sales in 2002 had declined to 1.2% of saes in 2007. ▪ The investigations conducted were not able to determine if this business was representative of the larger Wholesalers of which they were a part. Certainly smaller Wholesalers would be expected to have lower operating margins and possibly	Section 5,

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		lower percentage margins as well depending on the balance of management / operational staff. ▪ The largest cost growth area related to costs incurred in areas associated with promotion (in conjunction with MSC), crates and palletising. Crates (RPCs) represented the largest increase. ▪ Further investigation of Mid-Chain organisations is strongly recommended in order to provide the ACCC with a sound understanding of the sharing of profits across the chain.	
[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?	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ The chain diagrams and discussions herein outline also that the main route of access for MSC is direct via Consolidators (Grower or Non-Grower). Similarly herein it is outlined that other Supermarkets, Independent Greengrocers, Foodservice and Processors source much more of their supply from Mid-Chain parties. ▪ The sample of Consolidators and Individual Growers who are supplying products direct to MSC confirm that in all cases across a season the average net price received by them is greater than if the product was sold through the Central Markets. The general consensus was the net revenue gain was in the order of 7-15 per cent when comparing net sales returns between MSC and other market channels. ▪ Some observers would question the finding on the basis of the perception that MSC select only certain quality lines and leave the rest for sale through the Central Markets. Our discussions with the sample indicated that this was not the case and that the comparisons are valid. ▪ Net sales returns from the Mid-Chain would be expected to be lower to Growers as at least one additional transaction cost is involved, double handling resulting in additional transport costs and the average cost of packaging compared with the use of RPCs adds further costs. ▪ MSC direct suppliers (Individual Growers, Consolidators) confirm that the payment terms offered by MSC at around 14 days, with the businesses operating in the Central Markets providing payment terms from 7 days to up to 90 days. Longer payments terms are associated with businesses that may be in financial duress or in some cases from Non-Grower	Section 3, Section 5, Section 6, Section 8.

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		Consolidators.	
[47]	Do grocery Wholesalers or Retailers with buying power pass on the lower prices they can achieve from suppliers to Retailers and consumers?	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ Anecdotal information suggests that consumer prices offered by MSC who possess the greatest market power at the retail level, vary greatly between products, at different times of year, depending on competitive forces at the local level and between lines (for example high volume staple lines verses smaller categories). ▪ Our observations based on discussions with MSC indicate that the net price return is in fact higher than if the same product was sold through the Mid-Chain. Therefore it is arguable that the use of price power by MSC is in fact just perceived or real. MSC realise that the demands that they place on their suppliers may result in additional costs which if their suppliers are to survive need to be rewarded. ▪ "Bad news stories" involving Growers and MSC may in fact be due to a number of factors. These include ○ Over-zealous demands or expectations from individual MSC buyers or Growers or less likely Consolidators. ○ Not comparing or understanding the quality demands / parameters of each other. ○ The information provided about poor MSC practices may be supplied by non-MSC suppliers who have had a poor experience and / or do not have all the available facts at hand. ▪ The interim observation herein is that whilst MSC may achieve cost economies by initiatives such as one-touch retail / retail-ready, and achieve cost economies in key cost areas (eg. freight) they still must compete aggressively with Independent Supermarkets and Greengrocers, who are strong in areas including waste management, presentation, labour costs (using family / owner labour), ranging / purchasing for their specific local market and lower management / corporate overheads.	Section 5, Section 6, Section 8.
[50]	Is there evidence that large grocery Wholesalers have market power as acquirers of	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by	Section 5.

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	products and what are its effects at the retail level?	suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ Of greater concern than the use of market power by large fruit and vegetable Wholesaler is the perception (by Growers, their organisations and advocates) that there is a wider use of inappropriate market power by those Wholesalers who are not willing to shift their business model to comply with the recently introduced mandatory Horticulture Code of Conduct, and the constraints to transparency through the ongoing use of merchant agreements and "pseudo agency" terms by less scrupulous Wholesalers. ▪ Our observations seek to stress that the inappropriate use of market power through transaction processes and information disclosure relates to a sub-segment of the Wholesaler sector. ▪ There is anecdotal evidence that suggest that a small section of Non-Grower Consolidators who have access to the MSC may use their position to exhibit inappropriate business behaviour in respect of sourcing policies and payments. ▪ Further investigation of Mid-Chain organisations is strongly recommended in order to provide ACCC with sound understanding of the sharing of profits across the chain.	
[52]	Are there other forms of behaviour or conduct by Supermarkets in their dealings with producers or suppliers that may indicate market power?	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ There is a constant level of concern expressed by the media and some sections of the production sector and its advocates that MSC misuse their market power to extract inequitable levels of profit / margin from the fruit and vegetable supply chain. ▪ However personal communications with numerous Individual Growers, Consolidators (Grower and Non-Grower) has identified that these companies are generally quite satisfied with the prices achieved and the ongoing relationships with MSC and Independent Supermarket chains. These suppliers did however comment that particularly where relationships must be maintained with State Buyers that the level of satisfaction is variable. This relates in part due to the communication skills of the buyer, the interpretation of standards and a view held by some buyers that they are in possession of the 'big stick' in terms of negotiations.	Section 6, Section 8.

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[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?	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ Anecdotal information gathered suggest that in fruit and vegetables the MSC are driven strongly by their belief that if they do not have a produce line that their competitor has they are missing potential sales. Thus their ranging decisions are driven by consumer demand. ▪ At the brands level information gathered to date suggests MSC who have Consolidators / preferred suppliers in a particular line will work closely with that supplier (i.e. non-consumer brand) in preference to shifting suppliers, due to the level of investment and trust that has been developed in the relationship, and the limited number of like suppliers (Consolidators) that could supply similar volumes, quality, timeliness, and communication skills. ▪ Comparatively, there is limited development or use of House Brands in fresh fruit and vegetables, apart from those goods that are pre-packed, where there is a strong move by both parties to supply house or private label brands. ▪ In the processed fruit and vegetable sector there is strong competition with overseas supplies of products. The strong brand recognition that many of the Australian fruit and vegetable Processors have eg. SPC, Golden Circle does provide these companies with some market power associated with maintaining their brands on shelf. The skills of the negotiator to adequately assess proposals to remove these products from shelves in preference to house / private label brands was not assessed for this submission. ▪ In other retail types there is often a stronger relationship between the Wholesaler, Broker or COS (Mid-Chain parties) and the Retailer than between the Retailer and the Grower of the produce. As a result of this Mid-Chain parties have considerable capacity to influence the Retailer about Grower brand selection. Mid-Chain parties and their Retailer customers do develop Grower brand preferences and impose them on their supply lines. ▪ Direct interaction with Growers, Grower Consolidators, Non-Grower Consolidators and Wholesalers has been undertaken in preparation for making this submission. The most notable concerns were, as discussed previously in this submission, egarding perceived lack of transparency in dealings between Wholesalers and Growers and the view of numerous parties	Section 5, Section 6, Section 8.

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		that there may be an inappropriate use of market power by some Wholesalers. ▪ The market power seen to be used by Wholesalers in their dealings with Growers is not achieved by scale alone. In the relationship between Grower and Wholesaler there are reported to be major cultural and skills differences between the parties, which is contributing to the disquiet between these parties: On one hand Wholesalers have many years of very direct transactional experience with large and small businesses that equips them particularly well to negotiate and communicate with Growers from a position of strength. On the other hand a large proportion of Growers by number are very small businesses that have been passed down through generations of farming families, exist long distances (physical and cultural) from today's aggressive commerce and whose managers and operators have not been trained in commerce or general business practices, rather having a strong skill set in technical and practical production matters. ▪ Importation of produce has increased over recent years as outlined herein. The factors behind this trend include government commitments to continue to reduce inbound trade barriers for fresh produce, lack of available acceptable quality product from Australian producers, either in total or in a specified part of the year round supply model or in inadequate volumes to satisfy consumer demand and inability, particularly at certain times of year, to purchase from domestic Growers at a competitive price. ▪ Some parties, including Grower organisations / advocates and the media, express concerns regarding the standards of food safety applied to imported produce, compared to that required by domestic Growers / suppliers. Reecent studies by HAL suggest that the processes and standards applied to each were not comparable and are worthy of further investigation. ▪ HAL and industry representatives remain concerned that appropriate checks and balances continue to be applied that ensure the prescribed standards and processes are at all times applied to imported produce.	
[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?	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ There are a number of significant influences on Grower profitability that are outlined in Issue #1 and covered in some detail in this submission.	Section 3, Section 4, Section 5, Section 6.

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		▪ The influences on prices achieved vary significantly depending on whether the Grower is selling direct to Retailers selling to a Grower Consolidator, or selling to a Wholesaler or Broker, or selling to a Retailer direct as an Individual Grower (or also Foodservice operators and Processors). ▪ A detailed examination of the pricing mechanisms for produce sold to the Central Markets is provided in Section 5.3. ▪ A detailed examination of the pricing mechanisms for MSC is provided in Section 6.4. ▪ A detailed examination of the pricing mechanisms for Independent Chain Retailers is provided in Section 7.2. ▪ One example provided in this submission (which requires ratification and expansion through the implementation of a detailed chain analysis process as strongly recommended herein) suggests that a Grower selling direct to a MSC in Victoria may receive 50% of the retail price. This example is for a large volume staple fruit product supplied to a Victorian MSC operator.	

	Per Carton	Per Kg
Net Price Returned to Grower	**16.90**	**1.30**
Freight	2.30	0.18
MSC Rebate	0.80	0.06
Sell Price from Grower to MSC (Corporate)	**20.00**	**1.54**
MSC Distribution Centre Charge	2.00	0.15
Sell in Price to MSC Store	**22.00**	**1.69**
MSC Store Gross Margin (35% Margin, equates to 54% Mark Up))	11.84	0.91
Retail Sell Price	**33.83**	**2.60**

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[67]	Have the prices you receive for your produce changed over	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices	Section 2, Section 3,

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	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?	and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ However in the time available it has been possible to gather information that suggests that Growers of fruit and vegetables perceive that the prices they are receiving for produce today has not kept pace with the increased costs that are impacting their industry and businesses. The magnitude of cost increases are discussed in some detail herein and summarised in Issue #1. ▪ Without the detailed chain analysis including that of tracking / analysing Grower returns it is not possible to categorically provide an answer to this question, due in part to the influence of environment in the supply of fresh produce.	Section 4, Section 5, Section 6.
[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 MSC? If so, what options do you have if you decided not to sell to the MSC (other grocery Retailers or Wholesalers, food Processors, exports, etc?)	▪ Growers of fruit and vegetable sell their produce to one or more of Consolidators, Wholesalers, Processors, or direct to MSC, Other Supermarkets and Greengrocers. ▪ The nature of the chain is presented in considerable detail in Section 3, with individual detailed supply chains described for each End User contained within the body of this document. ▪ The division of product volumes sold to various End Users is dependant on the individual Grower. An overall analysis of the volumes moving along the many channels is difficult to complete due to the fluidity and changing nature of each of the channels that exist.	Section3, Section 4, Section 5, Section 6, Section 7, Section 8, Section 9.
[69]	If a MSC put pressure on you to lower your prices would you attempt to 'make this up' by charging more to other	▪ In the fruit and vegetable categories, the vast majority of Growers are price takers and not price makers. This relatively vulnerable position is further exacerbated by the fact that, with the exception of a small number of large Growers, (the majority of whom have become Grower Consolidators or large Network Growers) they have limited knowledge of the markets they are selling into. Further, they demonstrate limited objective knowledge of accurate costs of production on a	Section 4, Section 6, Section 8.

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	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?	unit of sale (kg percarton) basis in many instances. ▪ In general when a Grower is unable to sell to a Consolidator or direct to a MSC or other Retailer the only real option available to that Grower is to sell to a Wholesaler or Broker. The anecdotal information gathered and provided herein suggests that the majority of the sales from Growers to Wholesalers are still done on the basis of a merchant agreement / transaction and thus the Grower gain little or no knowledge of which Retailer purchases his product, what price it is purchased at or the margin / fee earned by the Wholesaler. ▪ Due to the highly competitive nature of both the demand and supply sides of the industry Growers have limited or no ability to extract additional margins from other chain members, particularly if their product is rejected by the MSC. In fact the opposite occurs, particularly where product is sold in RPCs, it either has to be repacked or is heavily discounted as the 'market' knows the product has been rejected. ▪ The skills of the marketer no matter at what stage in the chain to understand the supply and demand dynamics of the product they are trading in is, is a critical element of the ability of that individual / company to extract what may be 'termed margins'.	
[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?	▪ The time available for the preparation of this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ Consolidators who have been provided access to supplying a large proportion (and/or the majority) of produce into a specific category would be the most likely party to be able to use (outbound) market power in selling to Retailers and Wholesalers. Further research is required to fully investigate if indeed any real use of outbound market power by these parties has been or is able to be applied. ▪ Further, the current price setting mechanism that is used for fruit and vegetables remains the Central Markets. There exists a few situations where Growers or Consolidators who have sole or vast majority share of a MSC supply category are able to develop pricing relationships external of the Central Market system and may be in a position to pass on at least some of the increased costs of doing business.	Section 3, Section 4, Section 5, Section 6, Section 7.

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		▪ Some of the largest Non-Grower Consolidators who are able to supply a basket of goods to MSC (and others) possess possibly the greatest potential to exhibit significant market power. The MSC are aware of this through having seen the lessons learnt in UK retailing and so have pro-actively developed 'additional supplier' strategies to countervail this.	
[74]	Are there any impediments to cost savings flowing through the supply chain to consumers?	▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input. ▪ Initial input to this submission suggests that the area most likely to experience impediments to the flow of cost savings through the chain is the transactions processed through the Mid-Chain, being Wholesalers and Brokers. In particular where sales from Grower to Wholesaler are on a merchant basis, with limited transparency communications between Growers and the rest of the chain, lack of clear market signals and constrained communications has significant potential to inhibit cost savings investigation and flow in the chain. ▪ Due to the competitive supply and demand nature of the industry Growers have no ability to pass on costs increases in their business. The limited exception to this is where the product has a high level of demand and there are limited numbers or one principal supplier. Growers are only able to obtain higher average margins than other Growers through: ○ their own business / negotiation skills, ○ their ability to produce products that are demanded in the timeframe where supplies are limited; ○ their ability to produce products of a consistently of a better standard (superior brand development); ○ their ability to work with others to supply longer, uniform lines of products to large customer segments; and / or, ○ their ability to work with others in the supply chain to 'solve problems' of others eg. Pre-packing, JIT deliveries. ▪ The ability of Mid-Chain and other elements of the chain to pass on costs is entirely dependant on their negotiation skills and abilities to negotiate 'superior deals'. ▪ In turn, MSC do not pass on cost savings associated with improvements in efficiencies in their business. ▪ An example of win-win situation deoes exist in regards costs savings being shared. Coles Supermarkets in the introduction	Section 3, Section 4, Section 5, Section 6, Section 7.

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		of their RPC program negotiated with Growers and Consolidators on an individual basis to pass on some of the cost savings generated by using RPCs. Some cynics would argue that by giving away some of the benefits of the introduction of the RPC program that Coles Supermarkets avoided potential issues associated with 3rd Line forcing.	
[75]	What are the consequences for suppliers of any market power of grocery Wholesalers or Retailers in the acquisition of grocery products (eg. lower prices to suppliers, transfer of risk and/or costs to suppliers, decreased incentive for investment and innovation along the grocery supply chain, etc.)?	▪ Growers (suppliers) who are impacted by the improper use of market power by Wholesalers and Retailers can: 1. potentially receive less than an equitable share of the profits generated in the chain; 2. be at risk of not being able to pass on increases in costs of production and supply (inequitable transfer of risk); 3. be at a disadvantage due to their inability to receive accurate market signals and open feedback / communication from the rest of the chain; and; 4. be discouraged from investing in developing new technologies for their business and discouraged from investing in enhancing their knowledge and skill sets, to better perform as chain participants. ▪ Initial research suggests the area of the chain where this may be most likely to occur is where product is initially transacted from Grower to Wholesaler on less favourable transaction terms (eg. merchant or "pseudo agent" basis). ▪ Discussions with SMC's indicated that in future they will be seeking even greater compliance to food safety and quality standards. The costs of meeting these obligations will be the responsibility of the MSC supplier and will not be able to be passed onto the MSC. ▪ MSC suppliers are as general grouping proactive in terms of the development of new products and offers and in the identification of strategies to reduce costs. The MSC commented that they would like to see more suppliers with this proactive approach however.	Section 3, Section 4, Section 5, Section 6, Section 7.
[76]	What are the potential consequences of suppliers having any market power along the grocery supply chain?	▪ In theory suppliers having market power could result in the passing on of increased prices as Growers (suppliers) attempt to take super profits. However, Retailers and Wholesalers appear to both implement strategies of supporting and encouraging multiple suppliers in any one category. ▪ Retailers (MSC in particular) are proactive in expecting (and monitoring) suppliers on a real time basis to deliver the key ingredients they seek from approved / preferred suppliers and demanding suppliers maintain standards in these key areas. Approved / Preferred suppliers (predominantly and increasingly Consolidators) are in a competitive environment and no	Section 3, Section 4, Section 5, Section 6, Section 7.

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		information collected suggests that these suppliers do not have the opportunity to apply market power. ▪ Whilst MSC did express some concern about potential power imbalances caused by the emergence of a number of very large Non-Grower Consolidators, both MSC have undertaken strategies to pro-actively support the development of other supply networks, in order to ensure the balance of power (in their eyes) does not tip to far back to the supply end of the chain.	
[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 fruit and vegetable supply chain has occurred in three main areas, being: ○ Retailers significantly investing in distribution centres and cold chain management pre-retail store, at the expense of pre-existing service Providors. ○ Consolidators (Grower and Non-Grower) significantly investing in distribution and logistics management facilities and capabilities ○ Consolidators investing in numerous examples in packing facilities, value-adding facilities and technology and, to a far lesser degree growing operations. ▪ The impacts of these investments, along with the impacts of Retailer driven initiatives like Project Mercury and others has been to improve reliability of supply and control of the handling of produce in the cool chain. In particular Consolidator investment in packing and logistics has been predominantly driven by a need to improve control of and reliability (security) of supply to satisfy the demands of End Users.(MSC and others) ▪ The impacts on pricing are harder to define, particularly since investment in integration and chain re-engineering (eg. project Mercury, RPCs. One-touch packaging etc) is seen by the supply end of the chain to have imposed significant initial infrastructure costs and costly changes to the operation of key processes such as packing and logistics. ▪ The movement towards the use of RPCs / One-touch packaging at the 'expense' of cardboard and styro carton manufacturers has resulted in cost increases for the later being maintained at close to zero. Some of the cost savings of moving to RPCs (if we discount chain re-engineering costs) have been taken by the produce packer and the remainder by the MSC. It is unknown overall what the level of cost sharing is across the fruit and vegetable chain.	Section 3, Section 4, Section 5, Section 6, Section 7, Section 8.
[78]	What impact, if any, does the	▪ All of the input provided by Consolidators and Growers who are selling direct to Retailers has highlighted a good level of	Section 3,

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	presence of direct supply agreements have on the level of competition in the markets for those individual products?	satisfaction with the terms of doing business and the nature of direct relationships. ▪ As stated previously the pricing of the vast majority of fruit and vegetables is determined by the supply and demand interaction at the Central Markets. To a significant extent the price paid by SMC's to their suppliers is dependant on the price performance at the Central Market. ▪ With the vast majority (>90% of Coles and >75/80% of Woolworths-estimated) product being supplied by Consolidators or Individual Growers outside of the Central Market system and the fact that this market segment represents 60-65 per cent of unprocessed retail sales (i.e. It doesn't include Processors or food service), the initial impacts on the Central Markets were considerable. ▪ There were approximately 17,151 horticultural businesses operating in Australia in 2003 (ABS) with an estimated 80,200 direct workers. Estimates suggest that 10,000 farmers only produce 18 per cent of the total volume produced. The aggregation of supply, to the point where adequate volumes of suitable quality can be combined is complex and costly. The significant, and increasing, role of Consolidators who sell direct to Retailers is indicated to have improved the access that Consolidators and their Network Growers have to this major market. Further Consolidators indicate that their direct Retailer relationships, and prices received are better than other channels. ▪ There is an enormous number of Growers compared to two MSC who are responsible for 60-65 per cent of fresh sales which would support the possible perception that this provides the potential for MSC to exercise consistent and real market power. Each MSC anecdotally currently has around 400-500 suppliers each. MSC have commented in the past that a significant percentage of Growers and Consolidators do not have the necessary skill, focus or understanding to work with them in developing a mutually profitable supply chain. ▪ Successful Consolidators comment on the fact that one of their largest challenges is to access enough product within the specifications required by their clients (Retailers / MSC) across the entire supply window, which is increasingly becoming 12 months of the year. ▪ It is outlined herein that for Individual Growers who are not acting as Network Growers for one or more Consolidators, their ongoing viability is contingent on them being able and willing to fulfil several performance criteria. These Growers and their advocates may question the future access available to them and thus their ability to compete. However our analysis and that	Section 4, Section 6, Section 8.

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
		of others previously, suggests that provided they are prepared to meet the challenges of the evolving supply chains in which they operate that Growers will have access to markets for quality produce. The question facing many today is can they achieve a profitable enterprise with the rising costs of inputs and operate in a competitive market environment that relies strongly on the forces of supply and demand.	
[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?	▪ Consolidators have stated that one of the criteria that they have been required to comply with in order to satisfy MSC in particular is willingness and capacity to provide private label lines including product support where those products require a level of prepacking and hence capacity to be branded. ▪ This fact in itself does not appear to have had any impact on competitiveness in the chain. It has however further supported and fostered the Consolidator model, as few Individual Growers have the capacity to supply adequate volumes of the required specification to support volumes in private label lines. ▪ Thus Individual Growers who have not joined a Consolidator network may represent similar view to those discussed in Issue #78 above.	Section 6.
[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 consensus from the initial research suggests that the issues (discussed in numerous issues herein and outlined in some detail in the body of this submission) regarding perceived inappropriate application of market power by some Wholesalers and the lack of transparency experienced when dealing through these Wholesalers, that are not inclined to comply with the intent of the mandatory Horticulture Code of Conduct, does have significant negative impact on the Growers in the production sector. ▪ As outlined in the summary response to issue #75 herein, significant consequences of this include Growers: ○ potentially receiving less than an equitable share of the profits generated in the chain, ○ being at risk of not being able to pass on increases in cost of production and supply (inequitable transfer of risk), ○ being at a disadvantage due to their inability to receive accurate market signals and receive open feedback / communication from the rest of the chain ○ being discouraged from investing in developing new technologies for their business and discouraged from investing in enhancing their knowledge and skill sets, to better perform as chain participants.	Section 3, Section 4, Section 5, Section 6, Section 7, Section 8.

Issue No.	ACCC Issue	Summary Response Herein: Specifically in Relation to Fresh Fruit and Vegetables	Cross References
		▪ This matter appears to be amongst the most significant of concerns expressed by the respondents who have to date provided input to the initial research. That is, Growers appear to have little or no ability to pass on any costs increases along the chain. ▪ Where the Mid-Chain is involved their revenue is largely determined by receiving a percentage for what they sell the product for or by transacting the product where they keep the difference between what they buy and sell the product for. In both instances it is their skills as a marketer that determines their revenue. They also have limited or no ability to pass on cost increases to MSC or other End Users. ▪ The time available for this submission has not allowed for a thorough analysis of the entire complex fruit and vegetable supply chain. A key recommendation of this submission is that a well-scoped analysis of revenues, costs, margins, prices and transaction dynamics be undertaken across the chain from retail all the way back to Grower, to be undertaken by suitably qualified personnel that have the ability and rapport to gain clear and accurate input.	

Source: CDI Pinnacle Management, 2008

2. Profile of the Australian Horticultural Production Sector

2.1 Industry Background

2.1.1 SCOPE OF HORTICULTURE

Horticulture includes vegetables, fruit, nuts, nursery, turf, cut flowers and extractive crops. It includes dried grapes and fresh grapes, but excludes wine. For the purposes of this submission we will only be making reference to the fruit and vegetable sector.

2.1.2 CROP PRODUCTION AND VALUE

The horticulture industry (all sectors included) is the third largest agricultural industry in Australia with a total gross farm gate value of production of $5.67 billion in 2003.

The top five fruit and vegetable crops (inclusive of wine grapes) by value of production and total of production in 2005 are presented in Table 2 and Table 3.

Table 2: Production of Australia's Top Five Fruit and Vegetable Crops, 2005.

Fruit	Production (t)	Vegetables	Production (t)
Citrus	504,610	Potatoes	1,333,159
Pomefruit	438,147	Tomatoes	424,950
Bananas	313,314	Root vegetables	401,323
Tropical fruit	192,621	Onions and garlic	294,790
Summerfruit	162,015	Brassicas	226,398

Source: HAL (2006)

Table 3: Value of Australia's Top Five Fruit and Vegetable Crops, 2005.

Fruit	Value ($ million)	Vegetables	Value ($ million)
Pomefruit	$453	Potatoes	$485
Bananas	$415	Root vegetables	$236
Citrus	$331	Tomatoes	$230
Table grapes	$278	Onions and garlic	$194
Summerfruit	$266	Brassicas	$167

Source: HAL (2006)

The estimated value of horticultural production (inclusive of wine grapes) by state is depicted below in Table 4. If the value of wine grapes is removed Queensland produces the greatest value of produce.

Table 4: Value of production, by State, 2005 (Includes Cut Flowers & Nursery).

State	Value ($ million)
NT	$54
WA	$545
SA	$1,349
TAS	$222
VIC	$1,581
NSW	$1,070
QLD	$1,534
Total	**$6,355**

Source: HAL (2006)

2.1.3 EMPLOYMENT

The horticultural production sector currently has 18,000 Growers, with 10,000 of these responsible for only 18 per cent of the total productive output. The remaining 8,000 Growers contribute 82 per cent of the total industry value(HAL, 2005). Please note that in the interim four years since this census was taken anecdotal reports suggest that significant numbers of Growers have left the industry. This submission is not able to provide any firm figures on what percentage this may be.

Total employment in horticulture on farms totals 80,200 with a further 9,800 involved in the processing sector (HAL, 2005). Accurate statistics on total employment are difficult to calculate due to issues with how employees are classified and the seasonal nature of the work resulting in some employees working for many firms.

Based on these estimates this level of employment represents 20 per cent of the total employment in agriculture is in horticulture.

The sector has a shortage of both permanent and seasonal labour. This creates bottlenecks and limits the ability of the sector to meet export and domestic market demands (HAL, 2005).

In rural areas, the mining boom is creating strong competition for labour. Further cross-sector competition for the limited pool of workers has had a significant impact on wage rates.

Labour forms a significant proportion of horticulture's production costs with Australian wages relatively high compared to international competitors (HAL, 2005). CDI Pinnacle (2005) calculated that based on data supplied by horticultural farmers in Queensland that labour costs are at least 30 per cent of total farm costs.

Based on the Queensland Fruit and Vegetable Growing Award and the now Federal Award that covers horticultural workers in the five year period 2002 to 2007, the casual hourly award rate of pay has increased 27.5 per cent, which is well above the CPI and Growers would argue well above the increase in the per unit prices received for their produce.

2.1.4 REGIONAL IMPACT

The major growing regions in Australia include the Goulburn Valley of Victoria, the Murrumbidgee Irrigation Area of New South Wales; the Sunraysia district of Victoria/NSW; the Riverland of South Australia; northern Tasmania; southwest Western Australia and the coastal strip of both northern New South Wales and Queensland. Nursery production generally occurs close to the capital cities. (HAL, 2006)

"…most of the GDP generated by the Horticulture Economy is produced in regional areas of Australia. Specifically, on average, around 66 per cent of the GDP in the Horticulture Economy, or about $4.6 billion, was generated in regional areas of Australia each year between 1998-99 and 2003-04" (Econtech 2005a).

2.2 Factors Impacting Cost Structures of Growers

The principal factors impacting on the viability of Growers currently revolve around the sometimes dramatic increases in input prices over the last five years and the inability to pass any or a significant proportion of these costs onto the Growers customer.

HAL considers the fruit and vegetable industry to be one largely governed by the forces of supply and demand, despite the fact that there does exist certain structural characteristics and behaviours of some individuals in the chain which do impact on the 'freedom' of the price setting mechanism. These factors are described in considerable detail in forthcoming sections.

HAL's investigations have highlighted the following factors that have impacted significantly on the costs structures of Growers and therefore their profitability.

These factors include:

- Award Wage Rates have increased 27.5 per cent over the last five years.
- Actual rates of pay have increased at a faster rate due to labour shortages caused by the lack of availability of workers.
- Indicative freight rate increases over the last five years have been 33.1 per cent, although where there is a lack of competition the increase has been over 40.0 per cent (anecdotally).
- Water entitlements have increased in certain areas by over $1,000 per ML, although in a number of irrigation systems there has been no or limited water supplies available at any cost. This has resulted in some cases in the loss of tree crops and very limited production of annual crops.
- Diesel fuel prices have increased an average of 52 per cent from February, 2002 to February, 2007. Over that period of time the diesel fuel levy rate has not altered, so therefore the actual percentage increase in net diesel prices paid is even higher than this.
- Packaging prices in the majority of instances have remained relatively stable over the last two years, although over the last five years packaging costs are estimated to have increased between 5

and 12 per cent. The slow rate of growth of packaging materials has largely been due to competitive pressures caused by the introduction of RPCs and we believe the results of inquiries and legal proceedings into the cardboard packaging industry.

- Whilst the change in fertiliser prices have been significant according to anecdotal evidence, confirmation of this view was not available in time for inclusion in preparation of this submission.

Other factors which have a direct impact on Growers costs due to their impacts on harvest volumes include:

- Drought. Whilst the majority of farmers will contend that dry conditions generally lead to good harvests, the extended drought in nearly all regions of Australia or at least in some regions over the last five years, has caused considerable irrigation water shortages which in turn has either stopped crops being planted, crops failing or in some cases trees or vines being removed or dying.

- Rain. In the last three to four months significant rainfall in certain areas of NSW and certainly Queensland has resulted in both the loss of crops in the ground and what will be significant delays in planting crops. The latter impact will in particular produce significant flow-on effects for input suppliers.

2.3 Horticulture's Importance in the Food Industry

Fruit and vegetables makes up about 13.3 per cent of household expenditure on food and non-alcoholic beverages (see Figure 2). Apples, pears, bananas and citrus contribute over a third of fruit consumption. A wide variety of other fruits make up the rest (see Figure 3). Potatoes and tomatoes together make up 23 per cent of vegetable consumption. The balance of share of plate of vegetables is widely dispersed (HAL, 2007, citing ABS 2006).

Figure 2: Share of Household Expenditure between Food and Non-Food Items, 2006.

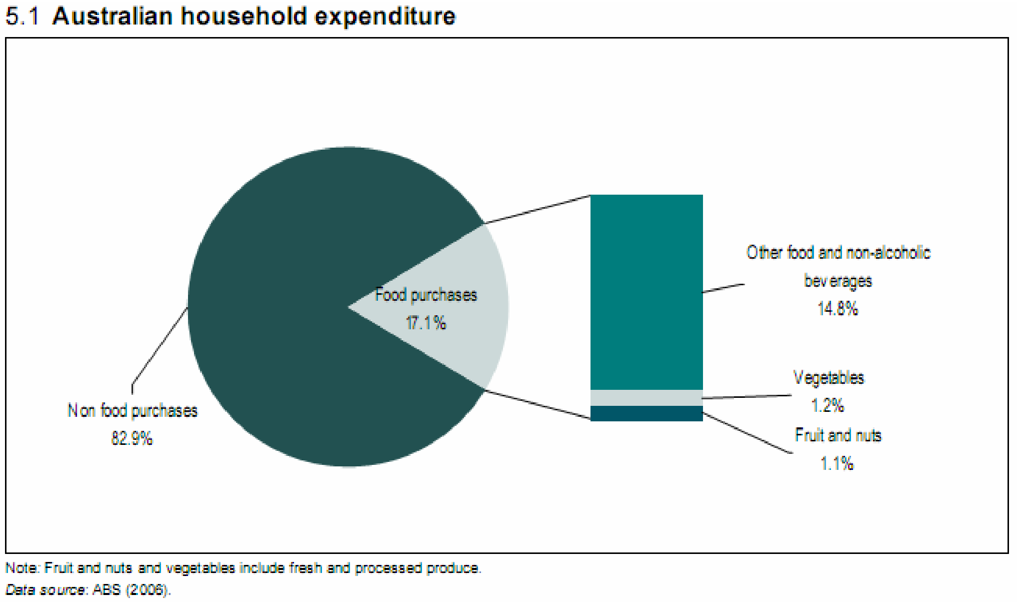
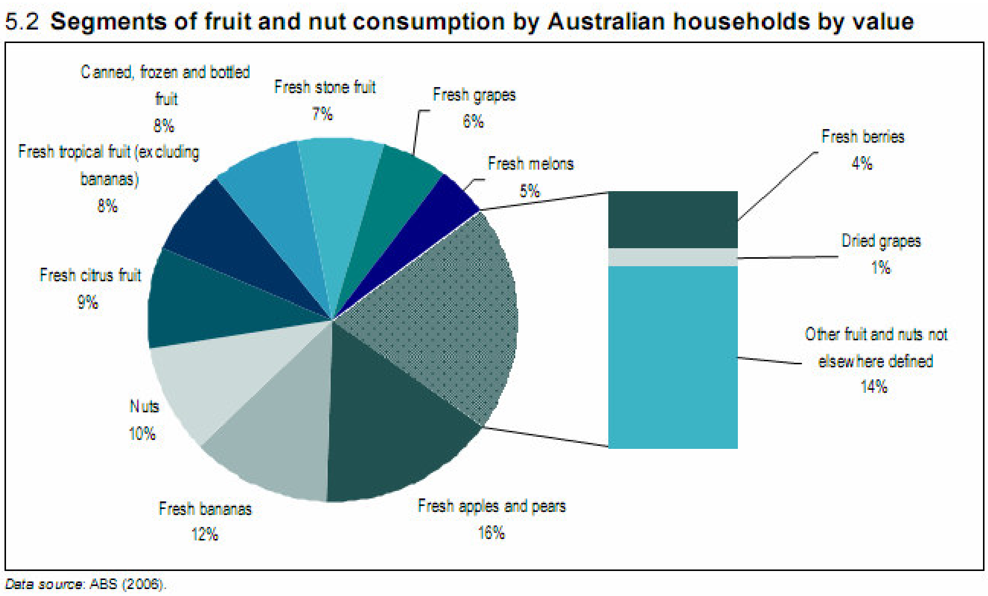


Figure 3: Share of Household Expenditure on Various Fruit and Nut Products, 2006.



3. The Australian Horticultural Value Chain

3.1 Horticultural Value Chain Participants

The Australian horticultural value chain by other agricultural standards is relatively short. That is, the product goes through few if any transformation steps prior to consumption. Even today the majority of fruit and vegetables are sold in their harvested form. The principal value-add for the majority of fresh produce involves grading and sizing.

Generally when produce is processed, it generally involves one transformation process, eg. fresh cuts, restaurant meals, frozen chips. Products that may involve multiple transformation processes are some of those goods that are processed into highly processed / refined consumer goods, eg. baby foods, sauces for meal components such as simmer sauces) and purees sold to dry grocery/frozen meal manufacturers.

However, whilst the horticultural chain is relatively short it is also quite complex, particularly beyond the farm gate where there a large diversity of companies acting in various roles as they supply produce to a variety of end users eg. Major Supermarket Chains (MSC), smaller Supermarket chains, Independent Greengrocers Retailers, food service and food Processors. The Mid-Chain participants include Wholesalers (agents and merchants), Brokers, Providores, Country Order Suppliers.

The Australian Horticulture Value Chain has the following participants involved in the Mid-Chain:

- Growers (Individual Growers, Network Growers, Grower Consolidators – Growing Division);
- Consolidators (Grower Consolidators – Consolidating Division, Non-Grower Consolidators, In-House Consolidators to MSC);
- Wholesalers;
- Brokers;
- Providors; and,
- Country Order Supplies.

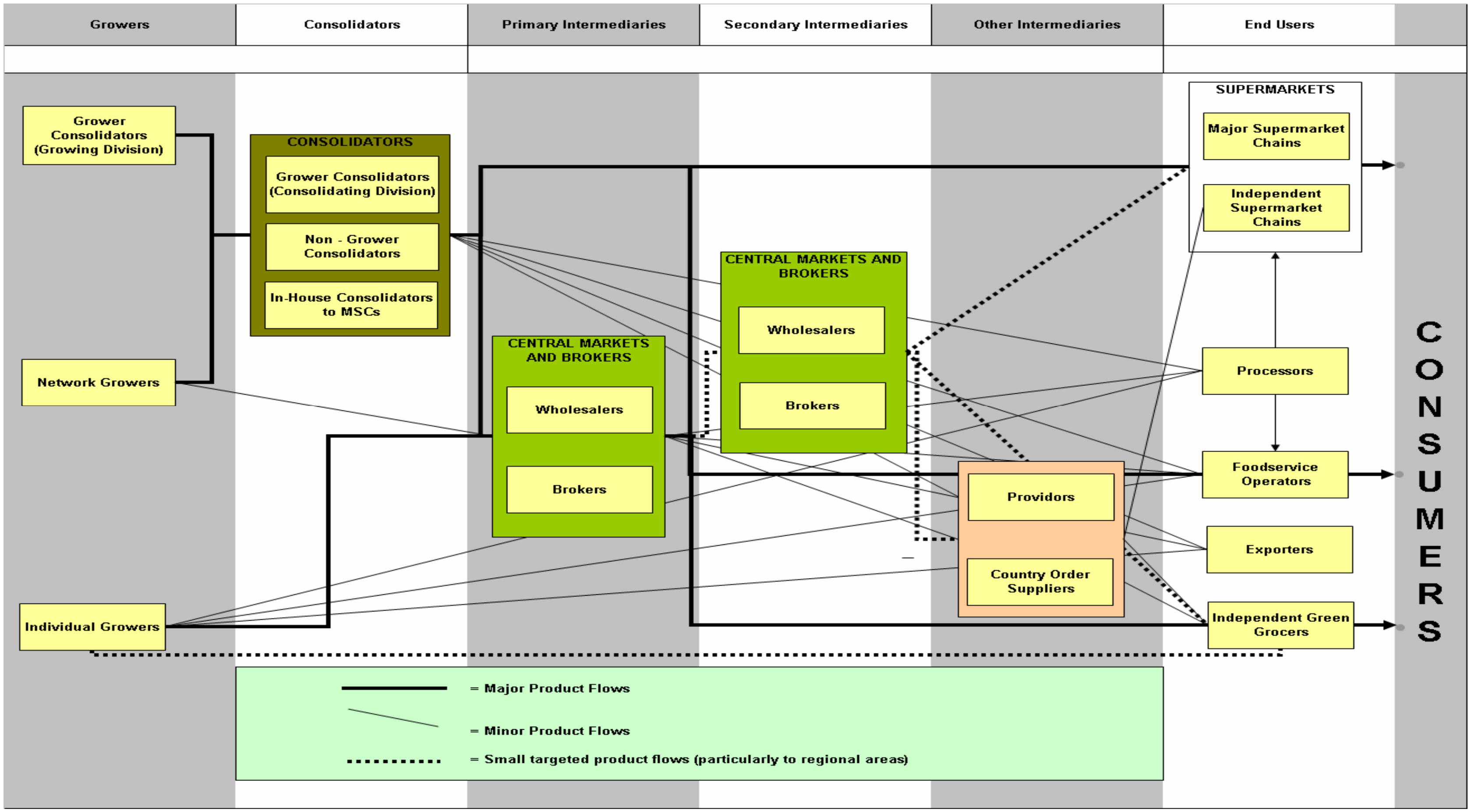
Further, fruit and vegetables are sold to consumers via the following End Users:

- Major Supermarket Chains (MSC) – Coles and Woolworths;
- Independent Supermarket Chains;
- Independent Greengrocers ;
- Processors ; and,
- Foodservice Operators.

Figure 4 provides a visual depiction of how produce moves through this chain. The diagram does not include any description of non-transactional steps such as freight movements, packing services. The diagram shows the flow of transactions, with those flows being relatively minor in the context of the overall transactional value of the chain shown by a thin line. Major product flows are indicated by thicker lines.

Forthcoming sections will discuss the major supply, demand, price setting and physical movement of these products across the chain, with a particular reference to how business practices may impact on the production end of the chain.

Figure 4: Current Australian Horticultural Supply Chain Structure



Source: CDI Pinnacle Management, 2008.

4. Growers

4.1 Types of Horticultural Growers

In Australia there is a wide diversity of enterprises (scale and nature) involved in horticultural production. The range is from hobbyists who regard horticulture as a secondary source of income or producers whose turnover is less (often significantly less than) $100K per annum up to family owned holdings who have sales in excess of $40 million per annum. Within Australia there still remains limited corporate horticultural farming with the notable exception of a number of tree and vine enterprises.

Further the nature of the relationships that each of these Growers has with their customers is quite variable. In analysing the production sector of horticulture today, there are distinct classifications of fruit and vegetable Growers. These have been illustrated in Figure 4 and are:

1. Individual Growers;

2. Network Growers; and,

3. Grower Consolidators (Growing Division).

In considering how each of these parties interact between themselves and with others in the value chain, a number of general characteristics can be attributed to each of the three producer classifications. These are described in Table 5 below. It must be noted that the characteristics discussed are general observations and are not relevant to all parties.

Table 5: Characteristics of Different Classifications of Australian Horticultural Growers

GROWER CONSOLIDATORS (GROWING & CONSOLIDATING)
▪ Grow, pack and market or facilitate the supply of same to a customer's specific requirements. ▪ Have orders or contracts to fill <u>prior to planting</u> or advise Network Growers what and when to plant. ▪ Market their own product and that of Network Growers, if a Grower Consolidator. ▪ There exists a variety of transaction mechanisms where produce is supplied to the Consolidator including product being sold to Consolidator (per weight or per unit), maximum / minimum pricing schemes, fee for service packaging and marketing and balance of return returned to Network Grower, fee for service for marketing, area contracts and volume contracts or combinations of the above. ▪ Consolidators seek or receive advice, guidance, instructions, support, estimates and other information direct from end users and trading partners (MSC, Other Retail Chains, Independent Retailers, Foodservice Operators, Exporters etc). ▪ Often have a good knowledge of where product is ultimately sold.

▪ Get information about supply chain and how to improve it direct from end user & trading partners. ▪ Are part of a **system** that supplies products to fit requirements of specific customers and are directly involved in decisions about who they do business with and what must be delivered to satisfy consumer demands. ▪ Product that is out-of-spec to end user requirements is most often sold to the Central Markets.
NETWORK GROWERS
▪ Operate as Grower members of a network. ▪ Are guided and directed by a Grower Consolidator or Non-Grower Consolidator. ▪ Have orders or contracts to fill prior to planting (this may not cover all their production). Network Growers may also produce and market some part of their product individually. ▪ Network Growers may be part of more than one consolidation network, although the varieties of products supplied will typically be different. ▪ Produce part of a substantial volume that is marketed via the Consolidator. ▪ Get advice, guidance, instructions, support, estimates and other information from Consolidator. ▪ May have reasonable knowledge of where their product is ultimately sold. ▪ Receive information about how their supply chain operates and how to improve it via consolidation. ▪ Feel they are part of a system that produces products to fit the requirements of specific customers.
INDIVIDUAL GROWERS
▪ Mostly produce without firm orders or contracts to fill. ▪ Generally have small volumes to offer compared to any significant customer's requirement. ▪ Generally sell via one or multiple Wholesalers, sometimes product goes through multiple Wholesalers before the product reaches the penultimate end user. ▪ Generally receive little feedback from Wholesalers, other Mid-Chain participants or end users as they form a small part of their customers total business. ▪ Have little knowledge of where their product is ultimately sold. ▪ Have low levels of knowledge about the supply chain in which they operate. ▪ Feel relatively powerless to do anything about changing the way they produce or market their products.

Source: CDI Pinnacle Management, 2006.

The volumes, values and shares of product that move along routes in the each chain is virtually impossible to estimate (with the possible exception of MSC). The total volume of production of each commodity is not accurately known. Government and industry information collection mechanisms can only be considered guides at best.

Industry sources suggests that the market share of fresh fruit and vegetable sales currently held by SMC's to be around 60-65 per cent and that held by Individual Greengrocers and Other Supermarket Chains to be 35-40 per cent. A number of industry sources confirm the relative market shares to have been relatively static in recent years. Woolworths are thought to hold 34-35 per cent market share and Coles 25-31 per cent, with the former continuing to gather market share at the expense of the later.

4.2 Consolidator Networks

History has shown that horticultural producers do not have a natural tendency to work closely with one another, unless in a co-operative or similar commercial relationship, many of which did not focus on marketing of fresh produce as the primary activity. So what has been the driver to the development of consolidation networks? Largely, consolidation networks have been pro-actively or subtlety developed as MSC actively continue to reduce their supplier numbers and / or forward-thinking larger Growers (and Wholesalers) recognised an opportunity to create larger commercial enterprises.

Consolidators, fall into two categories presently. These are:

1. Grower Consolidators: Are Consolidators who grow produce in their own right, but who also co-ordinate / direct other Growers to supply them. Grower Consolidators are the company who has the relationship with the Wholesaler / Retailer / exporter. It is rare for Network Growers to have a full awareness of the commercial arrangements between the customer and the Grower Consolidator.

2. Non-Grower Consolidators: Are Consolidators who do not grow produce but who work closely with a limited number of suppliers to develop programs for the Retailers or Processors. Growers may or may not participate actively in the relationship between the Non-Grower Consolidator and Retailer or Processor. In many instances the financial relationship between the Grower and Consolidator is different from a Grower / Wholesaler relationship. In many instances, this type of Consolidator is either a current or former market Wholesaler. Non-Grower Consolidators are responsible for all activities associated with the relationship except the growing, packaging and in some instances the movement of the product. Some Non-Grower Consolidators may have financial investments in packaging operations, further strengthening / tying the relationship with the produce. Examples of this Consolidator type, include Perfection Fresh Produce, Favco, Moraitis Fresh and Chiquita.

A third type of Consolidator was in existence until recently, that being of the In-house Consolidator. In-house Consolidators had a contractual relationship with a MSC to acquire a 'basket of goods' on their behalf for which they are paid a fee. The In-House Consolidator worked on behalf of the MSC and so their first loyalty would have been to minimise the acquisition cost to their customers.

Both C&S Global and Costa's were examples of this type of Consolidator. Both these parties acted as an In-House Consolidator for Coles. They were both paid 4 per cent of the 'sell in' price. Industry sources suggest the procurement relationship terminated in the last 12 months was done as a result of Coles not believing the service provided enough value. Coles had already invested in procurement personnel and so 'adding' the basket of produce these Consolidators handled could be achieved at a cost lower than what they were paying. Further, sources suggest that were concerned they were getting 'too far away' from their suppliers, a situation that they did not wish to continue.

4.3 Rationalisation of the Production Sector

Rationalisation has and continues to occur as the result of farming costs escalating at a faster rate than revenues. The impact of the revenue-cost squeeze on farmers (particularly smaller ones) has been that:

1. Farms are moving into more intensive or high value cropping and / or specialised production eg. shade house production;

2. Smaller farms have been bought out by neighbours or others in order to make bigger productive units;

3. Smaller farms have sold out of the industry with the farm area being used in some other form of land use, eg. Property development;

4. Smaller farms have had to get bigger by acquisition and / or increased borrowings; or

5. Smaller farms have had to become suppliers to other aggregators or Consolidators (that is becoming Network Growers).

Due to the relative low costs of entry for many horticultural crops, particularly some vegetable crops, there has been over time a significant movement in and out of the industry by opportunistic farmers. These farmers are either involved in other agricultural enterprises or have jobs in areas other than agriculture.

As horticulture has become more and more specialised and technically advanced the margins available to these 'opportunistic' farmers have become less and so their presence is no longer as evident.

As an example, one of the greatest areas of aggregation / Grower movement out of the industry has occurred in the Bowen tomato industry. Industry sources suggest 15 years ago, there were 50-70 tomato farmers in the region. This number has now decreased to eight, with five significant operations. Some farms in that region are producing well over one million boxes of tomatoes per annum, whereas 15 years ago a producer of 250,000 boxes was considered very significant.

So what has driven this revenue-cost squeeze at the Grower level in horticulture? In its simplest form it is the general overproduction driving down real prices, in conjunction with the general tracking of input prices with the consumer price index (CPI). The major causes of this over production are:

1. Extension of production time zones in many traditional areas, whereby producers move out of their traditional zones in order to hopefully gain a market advantage if other regions 'fail';
2. Opening up of new production regions, particularly in respect of fruit production whereby supply windows are lengthened;
3. Development of new varieties allowing for increased per unit area of production and / or more regular or consistent production;
4. Technical advances allowing for greater recovery of yield, more efficient harvesting and improvements in transportation and cooling technology;
5. Limited per capita growth in produce consumption; and,
6. (Possibly most importantly) the poor communication of price signals down the chain to the production end.

There are no recent statistics indicating the number of Growers who are currently involved in horticultural production, with the most recent having been collected in 2003. Anecdotal evidence however suggest that the number of Growers who have left the industry are significant as a result of the factors presented above.

4.4 Major Factors Influencing Grower Profitability

Major influences to the costs and operational structure of the production (Grower) sector include:

1. Cost of Labour. Since 2003 the gazetted hourly rate for casual labour has increased 27.5 per cent (Source: Growcom, pers. comm., 2008). Industry sources confirm however that the actual average hourly rate increase to be closer to 30-40 per cent as Growers need to outbid other industries to gain access to labour. Particularly in areas adjacent to mining and mining service industries the cost of labour has increased dramatically.
2. Seasonal labour availability. Seasonal labour is becoming less and less available, particularly in its preparedness to undertake the physical demanding harvesting operations. In numerous crops crews of ethnic workers managed by a single entrepreneurial ethnic individual, travel from region to region as the

harvest window moves (eg. table grapes). Additionally, many major horticultural production regions today rely heavily on foreign backpackers to make up the required labour numbers (eg. the majority of Queensland horticultural regions). Further the organisations that represent labour are being increasingly successful in raising minimum award levels. These two factors will continue to impact adversely on the competitiveness of individual farmers. As indicated previously mining and mining services industries has also negatively impacted on worker availability.

3. Access and cost of water combined with labour and prices received for produce are the major factors impacting farm viability. The cost of acquiring and accessing irrigation water include ongoing usage costs (annual per unit used), initial acquisition costs (acquiring water allocation) and capital infrastructure costs on-farm and near-farm. Increasing government regulation of water resources, lack of capital development works , a trend toward 'user pays' and water 'trading' all suggest that farmers will be faced with increasing management pressures for the water they do use and the costs associated with being given access to it will also cause significant impacts.

4. Increasing costs to Growers of compliance, both governmental, quality management and other 'through' chain prerequisites. Through chain compliance issues include costs associated with delivering to very tight Retailer specifications (effectively reducing high grade pack-out percentages) and costs associated with introduction of RPCs (Returnable Plastic Crates) and similar Retailer driven initiatives.

5. The development of, availability of and cost of new technology. In particular consumer demands increasingly drive fruit and vegetable suppliers to strive for consistency in eating quality, requiring capital intensive technologies to deliver "Guaranteed Sweet", "Ripe and Ready" and similar new product sub-categories.

6. Drought is a significant factor. However it must also be remembered that in times of drought, provided Growers have the water (irrigation) this is the best time to grow high quality and large volumes of product. In recent years the impact of drought has been substantial as it has persisted for so long that in many production regions the reserves of irrigation water (in surface storages and in the artesian systems) have been heavily depleted.

7. Flooding rains. In recent months the continued periods of wet weather in northern Australia, including the Bowen basin, will significantly delay the planting of winter harvest vegetables (tomatoes, capsicums, cucumbers etc) resulting in expected shortfalls in supply in the mid-winter period therefore causing a spike in pricing which may continue for four to six weeks.

8. Change in fuel and farm input prices. Since 2003, the average cost of freight has according to one source increased 33.3 per cent (National freight operator, pers comm.), inclusive of fuel level. Further anecdotal evidence suggests that the price of all fertilisers have increased significantly in recent years. Due to time limitations HAL were not able to confirm the extent of these price rises.

9. Changes in packaging costs. Costs of traditional packaging (cartons, lids, trays, inserts, bulk bags) move in line with inflation. Additionally the increasing demands of consumers for pre-packs, '"guaranteed sweet" and "ripe and ready", microwave packs and similar convenience product formats continues to add new costs which in turn move in line with inflation.

10. Temperature extremes – cold and hot. The impacts of cold and heat on crop yields and quality are possibly greater than drought. For example, short periods of hot, dry conditions in southern Australia has had a major impact on the supply and quality of salad vegetables in recent months.

11. The impact of urban encroachment into traditional farming areas has resulted in increased management

costs to ensure issues such as spray drift do not arise.

4.5 Future Structure of the Horticultural Production Sector

The Australian horticultural production (Grower) sector over the decades has undergone considerable rationalisation, which is expected to continue in the future. This is because as the growth in fruit and vegetable demand fails to keep pace with industry's ability to produce it within Australia, and internationally, and as we become less competitive in relation to our competitors, particularly given exchange rates movements, the industry will face a virtually constant state of oversupply (under demand).

Further, those higher up the value chain are increasingly developing strategies that focus on forming relationships with those who have the ability to produce high quality produce in sufficient volumes over an extended time period. In order to meet the needs of the larger Retailers and Processors, either producers will become larger and/or more and larger Consolidators (Grower, Non-Grower) will emerge. Grower Consolidators and large Growers will have to possess skills ranging from on-farm management, preparedness to adopt and invest in innovation both within and beyond farm gate, category management skills, an ability to interpret and manage information across the chain and a willingness to invest in relationships across a variety of organisations in the chain. The need to develop such skills will preclude a large proportion of the producer population from achieving these positions in the value chain. In most instances, producer Consolidators and large Growers will develop these skills Independent of traditional industry organisations and, rather, will recruit suitably skilled personnel or use external consultants.

Grower and Non-Grower Consolidators will require producers who are part of these networks to have an entirely different set of skills. These producers will need to be able to work within a consolidation framework whereby they are able to deliver to the specified needs of the Consolidators, to a pre-agreed packaging format, volume and grade. In many instances their ability to deliver to these pre-agreed standards will by negotiation determine the level of rewards.

Individual Growers will continue to survive and prosper if and only if they are able to:

- Produce high quality specialty crops in a cost efficient manner whereby the size of the market precludes entry by larger players.
- Produce crops to the exacting specification of buyer, whether they be a Retailer, Wholesaler or Processor, and/or Consolidator.
- Be increasingly quality focused. The low quality end of the market is becoming smaller and Wholesalers in particular will wish to deal with only quality suppliers as their customers only have demand for such product, and/or;
- Have a marketable point of difference in terms of the product that they produce.
- Adopt business practices and knowledge that enables Growers to understand and act upon market signals, information provided by others or discovered by self, combined with strong on-farm skills.

Individual Growers who do not address these needs will face challenges to their commercial survival, as they will become increasingly irrelevant to the rest of the chain.

5. Mid-Chain

5.1 Mid-Chain Participants

The Mid-Chain in Australian horticulture involves the following parties:

- Wholesalers – Primary & Secondary.
- Brokers.
- Country Order Suppliers.

For the purposes of shared understanding this report a description of the activities of each of these parties is presented below in Table 6.

Table 6: Services and Customers of Horticultural Mid-Chain Business Operations

Party Grouping	Primary Services	Primary Customer/s
Primary Wholesaler	Receive produce from Individual Growers or Grower Consolidators to market on their behalf or facilitate sale to other parties in the chain. This grouping is by far the largest in terms of produce handling to end users. Primary Wholesalers may 'trade' between themselves.	MSC, Other Supermarket / Grocery Chains, Individual Greengrocers, Processors, Providors, Country Order Buyers, Food Service,
Secondary Wholesaler	Purchase produce from Primary Wholesalers for subsequent resale. They do not have a direct relationship with Growers.	Processors, Regional Retailers, Food Service principally.
Brokers	Receive produce from Individual Growers or Grower Consolidators to sell on their behalf. Brokers do not have 'shop fronts' from which they sell their produce as opposed to primary Wholesalers.	Other Supermarket / Grocery Chains, Individual Greengrocers, Processors, Providors, Country Order Suppliers, Food Service
Country Order Suppliers (COS)	Purchase produce on behalf of regionally based Individual Greengrocers and small Supermarket / Grocery Chains. COS organise the transport and storage logistics on behalf of the buyer. They generally have facilities in the major metropolitan markets and / or may have storage and distribution warehousing in regional areas in which they operate.	Regionally based Individual Greengrocers, Small Supermarket / Grocery Chains, Regional based Processors.

Source: CDI Pinnacle Management (2008).

In Australia it is estimated that there are approximately 975 Wholesalers operating in metropolitan and regional centres. Of this approximately 370 are located within the Central Markets of the major metropolitan centres (Source: Australian Chamber of Fruit & Vegetable Wholesalers, pers comm, March 2008).

By state the estimated number of primary Wholesalers operating at the Central Market currently are as presented in Table 7.

Table 7: Estimated Current Number of Wholesalers in Major Metropolitan Markets, 2008.

State	Number
Brisbane	51
Sydney	120
Melbourne	127
Adelaide	49
Perth	23
Total	**370**

(Sources: www.sydneyfreshmarkets.com.au, www.brismark.com.au, www.melbouremarkets.com.au, www.adelaidemarkets.com.au, www.perthmarket.com.au, Visited 7/3/08.)

Beyond these figures each of the Central Markets have Secondary Wholesalers who source produce from Primary Wholesalers for subsequent re-sale to food service operators, Country Order Suppliers and smaller Processors.

Additionally, there are many Secondary Wholesalers who operate from outside the markets although they buy principally from the markets or from smaller local Growers. They perform similar roles to the in-market secondary Wholesalers but generally have a lower investment in infrastructure and are more 'opportunistic'.

5.2 Central Markets

Central produce markets are located in each of the major metropolitan centres in Australia, with the exception of Hobart and Canberra. These centres act as the hub for the movement of significant volumes of product from farm to end users. The only other major logistical pathway for Australian produce that by-passes the Central Markets is from farm direct to the distribution centres of MSC.

Traditionally, Central Markets in the major capital cities were the centre piece of the selling and distribution system associated with horticultural produce. The normal practice was that producers delivered produce to their agent on consignment to sell on their behalf. The buyers for the Supermarket chains 'trawled' the Central Markets and purchased their requirements on an opportunistic basis. There was little, if any, information exchange or supply co-ordination—practices that have over time became the focus of some Grower discontent and mistrust.

Although Central Markets do continue to perform these roles, the percentage share of total product volumes that move through Central Markets has over time declined as more direct linkages having been formed between Growers, Consolidators and MSC.

Dunne & O'Keefe (2004) estimated that MSC purchased 40 per cent of their requirements from the Central Markets. We can not dispute this figure as it is not possible to estimate what proportion of the MSC requirements come from Non-Grower Consolidators. Industry sources however suggest that only 10-15 per cent of produce purchases from the Central Market by MSC is in the form of 'top ups' to contracted supplies.

Today, Central Markets have five primary functions for the sale of produce:

1. Receival of produce by Non-Wholesalers for on-forwarding to customers by way of Non-Grower consolidation networks. For example, in Brisbane, CS Global receives produce direct from Growers / suppliers who then organises the distribution to Coles stores or other customers. In this event the 'contracting' point for the sale of the produce is outside the wholesale marketing system. There are many other examples of this type of role by the Central Markets.

2. Receival of produce for subsequent sale by Wholesalers.

3. As a transportation, storage and logistical hub for the movement of produce.

4. In southern centres, such as Sydney and Melbourne, as a centre to allow fruit and vegetable Growers (or their 'agents') to directly supply and sell their produce.

5. As a centre for the processing of fruit and vegetables by Providors and Processors for supply to the food service industry.

The wholesaling sector relies heavily on the Individual Greengrocers, Independent Supermarket chains and smaller Processors and food service companies. Any substantial rationalisation of the first two groupings in particular will have a significant flow on effect for Wholesalers who have not developed a consolidation role to MSC.

5.3 Mid-Chain Pricing Mechanisms to Growers

5.3.1 TYPES OF TRANSACTIONS

Horticultural producers sell produce to Mid-Chain members of the chain under four different marketing 'arrangements'. These are:

1. Merchant transaction.

2. Agency transaction.

3. Broker transaction.

4. Agreed price setting mechanism, eg. fixed price, agreed price one week in advance, negotiated price within a maximum and minimum limit.

Each of these arrangements have certain rights and obligations into how each party to the transaction must behave commercially. Further, the predominant transaction method varies depending on to whom the producer sells to.

For Wholesalers, the principal transaction types with Growers are merchant, agency or 'perceived' agency transactions. Brokerage transactions are not regularly used by Wholesalers, rather they are left to 'specialist' Brokers.

Broker transactions are generated by Brokers who either sell to Wholesalers, direct to Independent Retailers or Independent Greengrocers or to Processors.

The fourth transaction type is predominately used by the processing sector and, where there are direct supply linkages to large Retailers or the organisation charged with facilitating supply and price negotiation on their behalf.

5.3.2 DIFFERENCES BETWEEN EACH TRANSACTION BASE

There are a number of basic differences between each transaction type. These are best summarised in Table 8.:

Table 8: Transaction Type Descriptions and Price Mechanisms

Item	Agency	Merchant	Broker	Agreed Price Setting Mechanism
Title in Produce	Remain with producer until produce is sold.	Generally passes to seller when price negotiated and agreed or on delivery whichever is the latter.	Generally passes to the seller when price negotiated or on delivery whichever is the latter.	Generally passes to the buyer when produce is accepted by the buyer.
Price Returned	Gross sales price less commission and prescribed charge, eg. Unloading, ripening fees.	Price negotiated between Grower and seller.	Gross sales prices less Brokerage fees and deductions for agreed prices	Variable price setting mechanisms. May be contracted price for a period i.e. one week, one month, whole of season or price negotiated based on market price OR negotiated price within a maximum and minimum price level OR combination of the above.
Indicative Deductions	10.0-12.5 per cent of Gross Sales indicated although actual charges up to 15 per cent typical.	Varies widely, although generally indicated to Grower that 'charge' is 10.0-15.0 per cent. Actual difference from price paid to Grower to price received may be less than zero per cent or up to +25/30 per cent for Individual consignments. Average 'charge' typically around 15 per cent.	4.0-10.0 per cent depending on the commodity, its sale value and volumes to be sold. More typical charges are at the lower end of the range.	No deductions. Trader makes profit on difference between sale price received for the commodity and the agreed price paid to the Grower.
Agreements Allowable	Not able to change basis of agreement.	Are able to extend time to negotiate prices, time to pay and delivery conditions.	Not able to change basis of agreement.	Subject to specific contents of contract.

Item	Agency	Merchant	Broker	Agreed Price Setting Mechanism
Contractable	Terms of agreement normally negotiated but not necessarily subject in practice to a formal agreement.	Terms of agreement normally negotiated but not necessarily subject in practice to a formal agreement.	Terms of agreement normally negotiated but not necessarily subject in practice to a formal agreement. However more formal agreements are struck with merchant transactions.	Terms of agreement are negotiated and agreed to in writing.
Payment Period	Normally around 15 working days from date of sell of produce.	Normally around 10 working days from price negotiation or by agreement.	Normally within 15 working days of sale of produce.	Subject to agreement.
Documentation	Account sale docket.	Purchase memorandum note or payment advice.	Account sale docket.	Purchase memorandum note or payment advice.
Maximum Commission (Deduction)	Has to be disclosed.	Does not have to be disclosed.	Subject to negotiation.	Does not have to be disclosed.
Transaction GST Applicable	Yes	No	Yes	No
Apparent Price Transparency	High	Low (generally)	High (generally)	Total

Source: CDI Pinnacle Management, 2006.

In discussions with Wholesalers it is apparent that the number of 'true' agency transactions whereby each consignment has the same percentage of commission deducted from each transaction are few. Wholesalers may indicate on their price returns that the produce has been sold on an agency basis, eg. gross sale = $15.00 less commission of 15 per cent or $2.25 = Net return of $12.75, but in effect it is a merchant transaction with the produce being sold for a higher or lower price.

In effect this describes a fifth transaction type used by Wholesalers which is a hybrid merchant / agency transaction.

Factors which influence the level of deductions from the Growers return include:

1. Deductions as specified in law (through the Code of Conduct).

2. The unit value of the product. Per pallet produce costs approximately the same to handle (eg. Stacking, forklift movements etc), no matter its value. Wholesalers may seek to achieve a higher percentage margin to cover overhead costs.

3. Volume of Product to be Sold. Wholesalers will apply a lower percentage marketing charge to product for which they can sell volume as opposed to smaller, low volume lines.

4. Perishability of Product. Where products are more perishable Wholesalers may charge a higher percentage marketing charge to cover against potential claims from buyers. Many Wholesalers do not wish to adjust returns to Growers resulting from claims to prevent the 'hassle of the negotiation'.

5. Skills of Supplier. Some Wholesalers may deduct higher charges if the supplier is not aware of the state of the market and what the 'true value or worth' of their product.

6. Product Uniformity. Wholesalers who are confident in the quality and consistency of the product that is provided by their supplier are more likely to charge lower costs.

7. Length of Relationship. Wholesalers are more inclined to support suppliers who have a track record of loyalty to them, as opposed to suppliers who move frequently.

Growers who market their produce on a merchant transaction basis are not entitled to receive information from the Wholesaler in regards to how much the Wholesaler sold it for and to whom. It also requires the Grower to have a higher level of knowledge about market and price movements, within the Wholesale sector.

5.3.3 INTER-WHOLESALER TRADING

Within the Mid-Chain there is a well recognised practice of Wholesalers trading produce between themselves, either within a Central Market or between Central Markets.

This produce is transacted on two bases:

1. On Consignment. The consigning Wholesaler provides the receiving Wholesaler with the product on the understanding that the consigning Wholesaler will receive a return based on the sale price achieved less a discussed and then agreed payment to the receiving Wholesaler.

2. Fixed Sale Price. Receiving Wholesalers agree a price to be paid for the product on the expectation that they have or will have a customer who will be prepared to pay a higher price including any additional costs eg. Freight, that may need to be incurred.

Growers frequently are not aware that their produce is traded between Wholesalers. This often causes issues with their own dedicated Wholesalers in other markets who see their produce on other 'stands'.

Some Growers contend that particularly if the product is sold on an agency basis that any 'extra' return from the sale of their produce is returned to them (less marketing commission). In practice, Growers normally do not 'share' in the extra margins that are achieved by the Wholesaler.

Wholesalers contend that the practice is required because otherwise their 'home' market may become glutted with product. Alternatively, the Wholesaler may argue that other Wholesalers may have access to customers that they do not.

Industry sources suggest that the amount of Inter-Wholesaler trading has declined in recent years as Growers become more savvy with the 'placing' of their produce. Again sources suggest that the amount of inter-market trade, as opposed to inter-Wholesaler trade within a single market to be in the order of 3-5 per cent. For Individual Wholesalers this figure may vary considerably. No party was prepared to provide an estimate on the level of inter-Wholesaler trade within single markets.

Beyond the business impacts of the practice, the effect of this practice is that inter-market trade will artificially inflate the volume of produce that flows into each Central Market as the product is effectively counted twice.

5.4 Grower / Wholesaler Relationships

Grower / Wholesaler relationships are subject to the highest level of mistrust, misunderstanding and lack of a combined focus of any other sector in the horticultural chain. Not withstanding this, there are a considerable number of producers and Wholesalers who enjoy excellent relationships.

1. Business Skills: Most Growers and Wholesalers are not actively working together to grow the market of the other. The basis of most relationships is generally price and price alone. Growers frequently argue that the price is not good enough, where as in fact the evidence shows that they in most instances do not really know if the price is satisfactory because they do not know how much it cost them to produce, pack and transport in the first place. Farmers are regarded as variable in terms of financial management skills, which is both surprising and concerning, as frequently the business operation has relatively high turnovers. In general, like-sized businesses outside of agriculture have an excellent appreciation of the costs of doing business and an active process associated with seeking how to remove or reduce such costs.

   An issue raised by some Wholesalers is that they do not have an accurate picture of what it costs a Grower to produce a crop. For instance, one Grower may say it costs them $8 to land a tray of mangoes on a Grower's floor, whilst the next says it will cost them $12 to produce a similar quality of product. Whilst scale economies and business management practices would state that there will be variability in the costs of production the fact that is a lack of benchmarked or collated industry information is seen as a major weakness.

2. Business Practices: Some and possibly many Growers and Wholesalers, have been guilty of unconscionable conduct. Incorrect size and quality marking of cartons, putting poor quality produce on the bottom of pallets, are all practices that have all occurred to Wholesalers at some stage of their careers. The ability to trust their supplier is important to a Wholesaler, as it gives them greater confidence in the selling of a Grower's product, in addition to reducing their costs of ensuring compliance and checking. Conversely, some Wholesalers have been exposed as keeping of "double books", providing misleading market intelligence, suggesting produce does not meet an acceptable standard

when in fact it does, as examples. Each of these business practices should be regarded as misleading and dishonest. The respective parties will argue that the other one 'deserves it' or similar. The fact of the matter is however that increasingly in today's world of modern communication that it will be less possible for both producers and Wholesalers to engage in such activities. Further it will not be tolerated by customers further up the chain.

3. Communication Skills: Many business organisations today outside of agriculture, invest considerable time and expense, in developing their expertise into how to deal with and communicate with customers. The level of this investment in horticulture is low by comparison. Whilst many Growers will question the value of such investment, the fact that many organisations do so, suggests its value. A similar proposition regarding low level of communication skills training is also arguable for Wholesalers.

4. Investing Time in the Relationship: As discussed previously, many Grower / Wholesaler relationships are focused on price as the arbiter of a successful relationship. Growers who claim to have an excellent relationship with their Wholesaler, often do so, based on the fact that each party has invested time in developing an understanding of each others business often extending to a more personal level. It is unrealistic to expect that every Wholesaler will be able to develop a close relationship with every Grower, the fact is that as a general issue it needs to be considered.

5. Distance: Growers and Wholesalers are often separated by considerable distances, when if in combination with some or all of the issues above makes the development of a close business and personal relationships difficult.

6. Role of Industry Organisations: Industry organisations are charged with the responsibility of progressing the interest of their members. Unfortunately, in some instances it is the vocal minority, many of whom have 'radical' views who drive industry organisation communications often to the detriment of relationships with other industry chain organisations. In horticulture there appears as a general rule to be a high degree of animosity particularly between producer and Wholesaler organisations. This lack of 'leadership' from the top is then often translated or filtered down to the actions of the 'rank and file'.

It has been quoted widely that the production sector is often dissatisfied with the price transparency that the Wholesaler provides to producers. Other issues such as the basis of transactions, payment terms and produce returns have also been raised as issues of concern by producers.

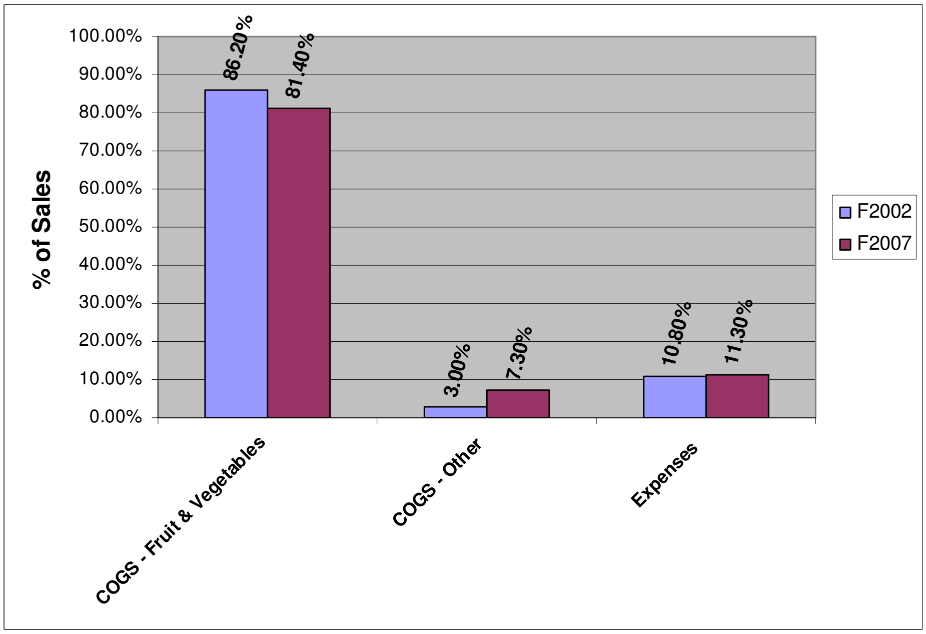
5.5 Mid-Chain Financial Performance

5.5.1 WHOLESALERS

Mid-Chain margins are not well understood or known and often subject to rumours associated with excess margins being achieved through 'manipulation' of Grower returns.

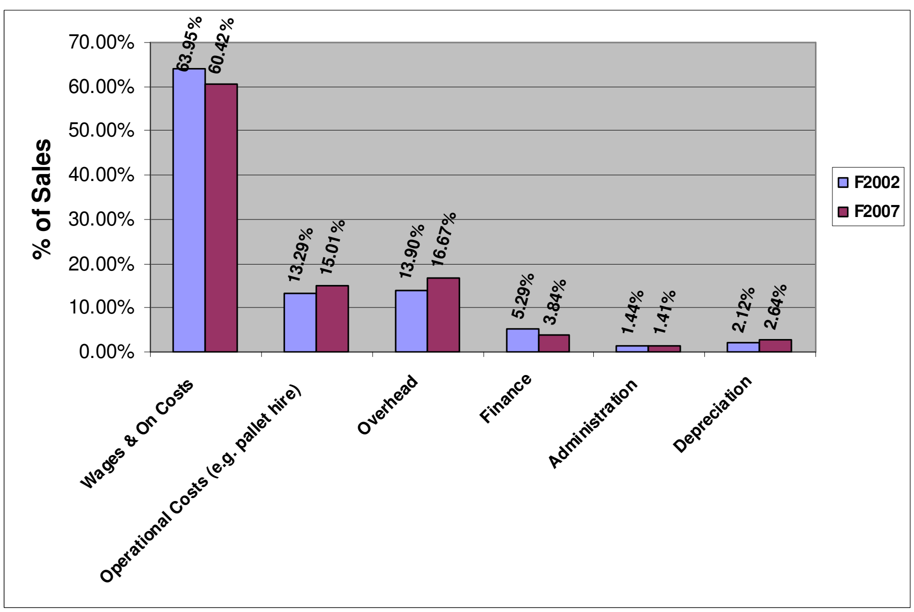
A brief analysis of one significant Wholesaler located on the east coast of Australia indicated the relative importance of different expense categories in their business. The figures are summarised in Figure 5 and Figure 6.

Figure 5: Major Cost Breakdown of Fruit & Vegetable Wholesaler (Confidential), F2002 and F2007.



Source: Confidential

Figure 6: Cost Breakdown of Expense Category of Fruit & Vegetable Wholesaler (Confidential), F2002 and F2007.



Source: Confidential

That same Wholesaler indicated over the last five years whilst their total revenue had grown 65.7 per cent costs had increased by a greater percentage of 73.0 per cent.

For this business, net profit before tax (NPBT) as a percentage of total sales was 1.75 per cent in F2002 and had declined to 1.20 per cent in F2007.

On this basis **for this Wholesaler** there can be no suggestion that this business is making excessive profits. Further examinations of other Mid-Chain business operations are recommended to identify whether or not low profit margins are commonplace across the industry.

Not unlike the majority of industries the Mid-Chain in horticulture encompasses businesses with vastly different turnovers. There are examples of Mid-Chain companies with turnovers well in excess of +$100 million per annum to examples of smaller primary Wholesalers with turnovers of less than $5 million and secondary Wholesalers less than $0.5 million.

Given the low level of turnover of wholesaling businesses the level of profitability of the wholesale sector must be sufficient to maintain those already in the sector and / or to attract new entrants as others move out. That said discussions indicate a number of the smaller and / or less progressive Wholesaler businesses are under financial duress. In order to turn their businesses around, these firms will need to adopt practices to support progressive Growers and to discourage poorer or smaller Growers, and identify market niches in which they can grow their business.

5.5.2 BROKERS

Brokers comparatively are not large volume handlers of produce. Their operational costs are comparatively low, with office space, administrative support and telecommunications the major cost centres for these operations. Concurrently, the fees received are low. Therefore Brokers rely heavily on generating sales volume in order to achieve an acceptable level of profitability.

Brokers generally provide a higher level of price transparency to Growers than what may apply with other Mid-Chain participants. By providing the transparency the benefits (or costs) of any movement in prices are readily transmitted through the chain.

HAL were unable at short notice to discuss the detailed returns, costs and margins with 'typical' Brokers. It must be noted that Brokers deliver very little product volumes to MSC.

5.5.3 COUNTRY ORDER SUPPLIERS

Country Order Suppliers (COS) work on behalf of the entity that they are buying the product for. Their remuneration is generally based on a combination of fixed handling charge (warehousing charges) which may or may not include freight costs to the customer and a commission charge based on the purchase value of the produce.

As an agent for the end user and an apparent high level of transparency to same, HAL would believe that the benefits (or costs) of any movement in prices are readily transmitted through the chain.

HAL were unable at short notice to discuss the detailed returns, costs and margins with COS. It must be noted that COS deliver no product to MSC with their customer focus being smaller Independent chains and Independent Greengrocers amongst others.

5.5.4 DISCUSSION – MID-CHAIN MARGINS

There has been no independently commissioned study that has assessed the profitability (or otherwise) of the Mid-Chain in horticulture. This lack of knowledge / understanding by the Growers of Mid-Chain profitability is one of the central sources of conflict between these parties. HAL acknowledge that frankly Growers probably do not have a right to be privy to this information. Secondly, are Growers going to be prepared to share similar information with the Mid-Chain?

HAL however would urge the ACCC to undertake a study that with the co-operation of the Mid-Chain would investigate in a case study format revenues, costs, margins and influencers to same.

Revenue and cost structures for Mid-Chain participants are not well understood. Mid-Chain businesses are reluctant to share such information as they do not wish to divulge their business performance into the public domain. This of course is not unusual for any type of family or Small-Medium Enterprises (SME) operation. This view is further enhanced with concerns that the information could be used against them by both their suppliers and customers.

HAL would recommend that a suitably qualified party should engage with selected members of the Mid-Chain to develop an improved appreciation of the revenues and costs associated with the operation of their businesses. Any contributor we believe would however wish (and should be able) to maintain anonymity and that certain sections of the information be maintained as commercial-in-confidence.

5.6 Brisbane Markets – Growth or Decline – Case Study?

Using the Brisbane Markets at Rocklea as an example there are countervailing arguments to support both cases.

For example, Brisbane Wholesalers point to the increasing value and throughput of the Brisbane markets over many years as the argument to say that the wholesaling sector is 'alive and well'.

Indeed, in the period from 1994 to 2003, there has been a 23.8 per cent increase in fruit and 1.8 per cent growth in vegetable throughput. Even more spectacular in terms of growth is the value of the produce, being 89.5 per cent for fruit and 90.3 per cent for vegetables (Market Information Services, 1996 & 2004).

Industry data suggests that the value growth has been driven by the following:

- Average unit value of major fruit lines such as apples, avocados, nectarines, oranges, peaches, pears, plums and watermelons have increased significantly.
- Average unit value of major vegetable lines such as carrots, cucumbers, lettuce, mushrooms, potatoes, shallots, tomatoes and zucchinis have increased significantly.
- Average volume of major fruit lines such as avocadoes, grapes, mandarins, nectarines, plums, strawberries and watermelons have increased significantly.
- Average volume of major vegetable lines such as capsicums, carrots, cucumbers, mushrooms, onions, shallots and zucchinis have increased significantly.

During the period 1995 to 2003, population growth across Queensland was 16.3 per cent.

Whilst the figures show there is throughput growth in the Central Market, others claim the sector is declining. There are a number of explanatory factors for this occurrence, including:

1. The gross unit value of produce has increased over time.
2. With the growth in the major metropolitan centres has come growth in demand for produce. Further, as evidenced in this report, the growth in annual per capita consumption of fruit in particular has increased the volume of product sold in the metropolitan markets.
3. The demise of markets in many of the regional areas, such as Rockhampton and Townsville in

Queensland, has therefore forced country Retailers to source product increasingly from capital cities such as Brisbane.

4. There has been a growth in the number of central receival businesses such as CS Global, IGA Distribution Centre, Simon George & Sons (Providores), Moraitis Produce and a variety of exporters, all of whom receive product from the production sector, but who in many instances do not use the services of the market Wholesalers to access produce.

5. For Queensland producers, Brisbane is often seen as a transit hub, i.e. produce comes in from regions west and north and then transhipped to markets further south by transportation companies whose operations are located within the markets. These figures are included in throughput statistics.

6. Retailers or Retailers agents, eg. CS Global distribution centres are increasingly being located within or close by the Brismark precinct. Produce to these businesses does come directly to them, by-passing the wholesaling sector. Once again these figures are included in throughput statistics.

7. Other businesses, eg. food service, food processing and Providores, have increasingly located their operations within the Brismark precinct. Where produce is supplied to them directly—which is anticipated to be a relatively small percentage of their total usage—this produce should not be included in 'Wholesaler intake'.

8. The interstate trading of produce by Brisbane Wholesalers is significant, particularly in regards to Queensland produce. Much of this trade is without the awareness of producers. Whilst technically 'Wholesaler intake', it can be argued that the produce is not consumed in Queensland and therefore not 'truly' marketed by Wholesalers to their endpoint customers.

The importance and current state of play of the Central Market sector in both Sydney and Melbourne is anecdotally similar to that of Brisbane although the growth rates of population are less. The position of Perth and Adelaide markets was not evaluated.

It should be noted that the data presented related to the comparison of a situation in 2003. More recent data analysis is required but was not possible to be completed in the timeframe associated with the presentation of this submission.

5.7 Future Roles of Wholesalers

Historically, producer perception of Wholesaler behaviour is of one where they portray asymmetric market behaviour. This has resulted in low levels of trust between producers and Wholesalers.

Growers see themselves as price-takers and hence possessing little market power. Historically, Growers have managed their risks through diversification of their agent, retail base and types and timings of when crops were produced. They have limited access (or in some cases we suspect limited actual usage) to independently verified pricing information beyond that provided by a few service Providors.

Wholesalers who do not have access to the major chains must maintain lasting relationships with Retailers. Other sectors, for example, food processing and Providores will not provide a substantial and reliable enough base for most wholesaling businesses alone. Wholesalers must differentiate their businesses in such as a way that they are seen as important by their customers. Examples of how Wholesalers have or may seek to differentiate their businesses include:

- Becoming a specialist in particular produce lines;

- Integrating their services directly with a Grower / Grower Network;
- Handling of certain high-value produce lines; or:
- Being a marketer of small 'end-of-stock' lines from other Retailers.

Some examples of these changing Wholesaler roles may include the:

1. Development as **Non-Grower Consolidators**, eg. Favco to large retail operations.
2. Development as a **Whole-of-Category Managers**, eg. Perfection Fresh Produce to large retail operations.
3. Development of a **Packaging / Formatting Consolidator** system similar to Macks Multiples in the United Kingdom supply system, whereby a company takes product from producers and repackages it into formats desired by retail customers. In many instances they are also responsible for distribution and logistics facilitation to major customer groupings.
4. Development as a **Specialist Wholesaler** who does not service chain Retailers but rather other customer segments, eg. Quality Fruits.
5. Development of a **Brokerage / Producer Chain Manager**, eg. Harvest Fresh Company.
6. Combinations of some of the above.

Individual wholesaling businesses will continue to be viable and valued members of the horticultural value chain if:

- They have a clear focus on the customer segment that they are servicing;
- They develop skills, systems and communication systems that enable them to be regarded as specialists in a particular market segment;
- They continue to add value to the business of their customers or develop a focus on the needs of their customer, both up and down the chain;
- They have 'quality' suppliers; and/or
- They invest in relationships / linkages down the value chain.

<u>It is agreed by all that the Wholesaler sector will have an ongoing role in the horticultural value chain, provided that the independent retail sector maintains it renaissance and MSC continue to source at least some product from the markets.</u>

6. Major Supermarket Chains (MSC)

6.1 Structure of the Sector

Two Major Supermarket Chains (MSC), Coles and Woolworths between them account for an estimated 55-60 per cent of all fresh fruit and vegetable sales in Australia. Other sources suggest the dominance is even greater in mainstream grocery with an estimated 80 per cent of all sales.

The majority of the balance of the market is shared between Independent Greengrocers and Independent Supermarket chains, eg. Metcash, IGA.

An estimate of the total number of stores held by Coles and Woolworths in 2003 and 2007 is presented in Table 9.

Table 9: MSC Store Numbers and % Growth, 2003 and 2007.

MSC	No. of Stores - 2003	No. of Stores - 2007	% Change Over Period
Coles	670	737	+10.0%
Woolworths	676	756	+11.8%

Source: National Association of Retail Grocers in Australia

6.2 Factors Influencing the Retail Sector

Whilst there may be relatively few players in produce chain retailing, the level of competition is high, as each seeks to gain an improved level of market share. In particular, the fresh produce category is currently in a strong competitive environment as it is seen to be the major point of differentiation between Retailers, whilst also delivering the highest level of margins within a store. Beyond returns per unit area, some of the other drivers that Retailers are seeking to address include:

1. Improved Variety of Offer. Reg Claires, former CEO of Woolworths commented that 15-20 years ago there were 40 lines of produce, and five years ago this figure had risen to 140, with experience showing this number has increased even further. An improved variety of offer is seen as a major differentiation point between Retailers. This improved variety of offers includes different new products or varieties and / or greater variety of formats, eg. pre-packed.

2. Consumer Demands for Variety. Consumers are demanding an improvement variety of assortment of offers, including produce that delivers improved levels of convenience, eg. fresh cuts, microwaveable packing.

3. All Year Round Supply: Consumers are demanding that produce of any type be available all year round, whether it is from local production or from imports. For example, grapes which were available for 3-4 months up to 10 years ago, is now available for up to 10-11 months of the year.

4. Food Safety and Integrity: Consumers are increasingly becoming health conscious particularly in regards to how the food they are presented with has been handled. Retailers are therefore driving the development of packaging formats that reduce the potential for infections from the handling of produce, eg. hepatitis. As a result Retailers are demanding the adoption of quality assurance systems, often in-house, such as Woolworths Quality Management and Coles SQF program.

5. Sustainability: Consumers are increasingly becoming aware of the resource / production sustainability issues. Issues such as the use plastic bags are modifying Retailer behaviour and similarly others will become higher on the agenda of consumers over time.

6. Stock Management: Consumers are not forgiving of Retailers who do not have available what they require whenever they require. As a result Retailers have increasingly focussed on inventory / stock management so that out-of-stocks do not occur. This has driven the development of JIT, supply programming and vendor stock management, whereby Retailers are working increasingly closely with vendors.

7. Cost: Competitiveness is driving Retailers to seek ways that they can drive costs out of their chain. Concepts such as lean thinking, Supermarket internalisation, category management, vendor management systems, waste / ullage control systems, ECR, self-scan, are all strategies being adopted by Retailers to either lower the cost of goods / inventory or minimise the transaction cost internally. Section 6.5.1 discusses in greater detail developments occurring associated with shelf-ready packaging for the supply of produce.

8. Supplier Rationalisation: Historically chain store Retailers purchased the majority of their stock from Wholesalers operating in the major capital cities. Over time Retailers have increasingly sought to develop alternative supply arrangements both with some of those companies operating within the wholesale market and more directly with Grower Consolidators. Section 6.5.1 discusses recent developments in the area of supplier rationalisation.

3\. Quality: The quality of produce is a major influencer in regards to consumer demand and choice of Retailer. Retailers are therefore less tolerant of variable quality produce and as such are increasingly seeking to identify suppliers who can both deliver the consistency of quality and length of lines. This is in part a major contributor to the drive to supplier rationalisation.

6.3 Structure of MSC Produce Supply Chain

6.3.1 SUPPLY SOURCES

MSC source product from three main channels. These are:

- Consolidators (Grower and Non-Grower).
- Individual Growers.
- Central Markets.

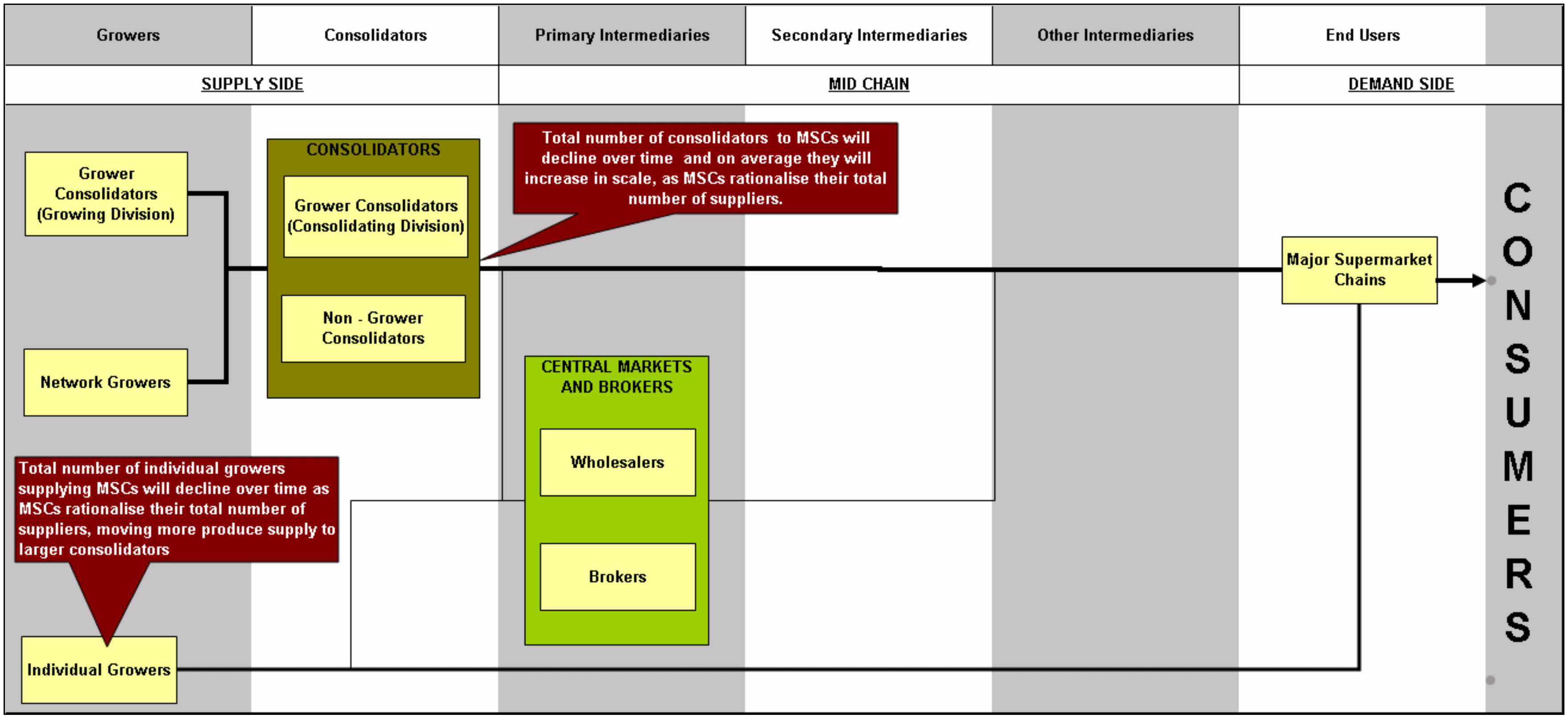
The percentage share that each group supply to either MSC is unknown. These figures would only be known by Coles and Woolworths.

What is known is that both MSC have a publicly stated policy that they wish to reduce the total number of suppliers to their businesses. For instance, Coles 2½ years ago had a total of 800 suppliers with that number now currently down to approximately 450 with plans to reduce this further within the next two years to around 250. Industry sources suggest a similar policy and Grower reduction whilst more advanced than Coles is still being undertaken by Woolworths. Industry observers suggest that the number of Approved Suppliers that each MSC has is in the range of 400-500 with a number of Growers being suppliers to both chains.

The reductions in supplier numbers will come mostly from the ranks of Individual Growers and accredited Wholesalers operating in the Central Markets. Individual Growers in particular who will be 'cut' will be encouraged wherever possible to form alliances with other Consolidators and so therefore become effectively Network Growers (see Section 3). Growers of course will have the option to 'opt out' of becoming Network Growers but such a decision will require them to become skilled suppliers as part of another chain.

A visual depiction of the MSC value chain is provided in Figure 7.

Figure 7: Major Supermarket Chains Fresh Fruit and Vegetable Supply Chain, 2008.



Source: CDI Pinnacle Management, 2008.

6.3.2 MSC PREFERRED SUPPLIERS

Both MSC operate Approved or Preferred Supplier (herein referred to as Approved Supplier) programs with suppliers. As presented in Section 6.3.1 an Approved Supplier can be an Individual Grower, Consolidator or a Wholesaler.

What is common to each of these categories is the fact that they satisfy virtually all of the characteristics that both MSC look for in a supplier. The essential characteristics of an Approved Supplier are:

1. They have long lines of consistent supply and quality of product;
2. They are to supply volumes of product commensurate with the needs of the Retailer;
3. They are able to lower transaction costs (by reducing the number of suppliers who have to be dealt with);
4. In combination with other suppliers, they are able to maximise the window in which the product is offered on to Retailer shelves;
5. They are prepared to develop pro-active relationships with the MSC with a focus on seeking innovative chain practices to improve the quality of the product, offer new products or present new products in new ways;
6. They are willing to support the MSC with product and funds to undertake market development / promotional activities;
7. That they are prepared to develop the "Family of Offer" and if required be prepared to move away from their own brands into house or private label brands; and,
8. That they are excellent communicators so that if (and when) a problem arises the issue is raised promptly and addressed in a professional manner.

Occasionally, press and medial releases suggest that Growers have a high degree of concern regarding the market power that they exercise. <u>Our discussions in the development of this submission indicate in general terms Growers who are approved suppliers have a high degree of satisfaction with the MSC relationship</u>. Moreover when compared with dealings with the Mid-Chain, they are significantly happier.

HAL's observations are that as a general rule it is not the business relationship practices that are placed in questions by Growers but rather the perception (actual or otherwise) that the MSC are making 'super' profits at their expense. HAL will this consider mechanisms how to address this perception in the Recommendation section of the Executive Summary.

6.4 MSC Supply Models & Strategies

6.4.1 ESTABLISHMENT OF SUPPLY PROGRAMS

An Approved Supplier is an Individual Grower, Consolidator or Wholesaler who is approved as a supplier to a particular MSC.

In the discussion herein in respect of the operation of the Approved Supplier Program we are not referring to Wholesalers. Wholesalers who manage supply programs to a MSC are referred to as a Non-Grower Consolidators. A Wholesaler in this instance refers to a company from whom MSC buy stock on an 'ad hoc' basis outside of the operation of a negotiated program.

Both MSC, request from their Approved Suppliers an 'Offer', prior to the commencement of each 12 month supply cycle.

As a minimum requirement the presentation must detail:

1. The minimum volume of product that they will have to offer.
2. When the product will be available by month.
3. Varieties and sizes (if known) of the product to be offered.
4. Desired or indicated revenue returns.
5. Strategies which they will pursue in association with the MSC to assist them to drive increases in demand and / or prices.
6. Confirmation of quality assurances programs, results of audits (if necessary) and proposed logistics arrangements.

These presentations are made to Coles or Woolworths head buying office.

Both MSC then review these proposals and in conjunction with the State buying managers will agree on what share (if any) that Approved Supplier will receive of the product/s that they wish to supply.

Sources indicate that Coles seeks to make offers on approximately 85 per cent of the total volume of product that they anticipate that they will require over the coming 12 months, with the percentage lower for Woolworths. The MSC do not commit to 100 per cent of anticipated volumes as they do not wish Growers to over extend themselves.

The MSC then provides an offer in return to the Approved Suppliers that details the indicative quantities that may be required, varieties, sizes, colours, packaging format, branding, sticker requirements (or not) and quality assurance protocols required etc.

The 'share of the product pie' that each Approved Supplier receives depends on a number of factors. These include:

1. Level of 'knock outs' received during the previous season.
2. Willingness or otherwise to investment in market development and promotional programs.

3. Reliability of supply.

4. Pro-activeness on matters of communication impacting on supply and price.

New Growers or Consolidators are not prevented from attempting to become Approved Suppliers. Our discussions highlighted though that a new entrant will only be granted entry if they can satisfy at least one of the following:

1. Are able to demonstrate an ability to supply a superior quality product.

2. Are able to provide product in a window that supply was not previously available for or had a greater risk of not being of an acceptable standard.

3. Are able to demonstrate ideas for the development of the category not previously supplied by other Growers. The MSC will also examine the ability of the potential new entrant to deliver on the promise.

<u>One Senior MSC Executive confirmed that the ability to supply product at a price lower than a competitor in a similar window is not a factor in determining whether or not a new supplier is 'taken on'.</u>

The total number of Approved Suppliers to MSC program varies considerably. Although exact numbers were not obtained the number of approved suppliers can vary from one to more than 12. The factors that influence the number of Approved Suppliers for a product include:

1. The total size of the category.

2. Potential quality variations caused by weather / environmental factors.

3. The relative size of offerings from the approved suppliers in relation to the total category size (a particular product category may have large number of small producers, where the nature of the product requires this).

4. The technology associated with the commodity being produced, particularly at packing.

6.4.2 MSC AND WHOLESALERS

Both MSC acknowledge that it is not always possible for their Approved Suppliers to deliver the volumes, qualities and provide the level of timeliness of delivery that they require. As a result MSC do on occasion purchase direct from Wholesalers operating at the Central Markets. <u>They must however be accredited or Approved Suppliers</u>.

Woolworths buyers have greater autonomy to purchase off Central Markets than do Coles buyers, principally because on average they 'contract' Approved Suppliers to supply a small percentage of their total overall requirements.

Some Growers on occasion have complained that MSC have purchased product off the Central Market at a cheaper price than what the approved suppliers were willing to provide it for. HAL's discussions with MSC personnel deny this will happen. Rather a MSC may re-approach their Approved Supplier to 'discuss' aspects of the negotiated price.

6.4.3 MANAGEMENT OF COLES SUPPLY PROGRAMS 'IN SEASON'

At the commencement of each weekly cycle (when the Supplier has product available) the following procedures are put into operation regarding securing supply for the following week.

1. On a Wednesday / Thursday the supplier makes available information on the volumes of product, qualities, sizes and colours for delivery for the week commencing the following Sunday. The supplier will also indicate the prices that they wish to receive for the product. The exception to this is where a supplier has a fixed price for an agreed period (can be a season or agreed shorter period). These offers are made direct to Coles National Head Office.

2. Coles National Head Office circulates the information to the state buyers.

3. Each state buyer collects information from the stores in respect of anticipated requirements for the week. By using available market intelligence sources they also determine whether the prices offered by the suppliers are reasonable.

4. Each state buyer confirms to Head Office their requirements and prices to be offered.

5. The offer to the Grower is made from Head Office and confirms volumes, qualities, sizes and colours and price delivered to each nominated Distribution Centre.

6. During the course of the week discussions on issues such as quality, possible adjustments to volumes required, delivery timings and fine tuning / adjustments of prices may occur between the state buyers and the supplier directly. Please note however price and volumes adjustments are relatively rare according to discussions held with a number of approved suppliers.

6.4.4 MANAGEMENT OF WOOLWORTHS SUPPLY PROGRAMS 'IN SEASON'

At the commencement of each weekly cycle (when the Supplier has product available) the following procedures are put into operation regarding securing supply for the following week.

1. On a Wednesday / Thursday the supplier makes available information on the volumes of product, qualities, sizes and colours for delivery for the week commencing the following Sunday. The supplier will also indicate the desired prices that they wish to receive for the product. The exception to this is where a supplier has a fixed price for an agreed period (can be a season or agreed shorter period). These offers are made direct to each State Buying Office.

2. Each state buyer collects information from the stores in respect of anticipated requirements for the week. By using available market intelligence sources they also determine whether the prices offered by the suppliers are reasonable.

3. Each state buyer provides an offer to the supplier and confirms volumes, qualities, sizes and colours and price delivered to each nominated Distribution Centre. These offers are normally made on a Friday.

4. During the course of the week discussions on issues such as quality, possible adjustments to volumes required, delivery timings and fine tuning / adjustments of prices may occur between the state buyers and the supplier directly. Please note however price and volumes adjustments are relatively rare according to discussions held with a number of approved suppliers.

Only just emerging in Australia is a role where Non-Retailers through consolidation networks are being given the responsibility of undertaking category management on behalf of the Retailers. A Category Manager is an extension of a supply manager, who undertakes to take responsibility for the merchandising, development of promotion and marketing material, placement and rotation of stock, receipt, analysis and interpretation of scan data. This concept is well advanced in the Fast Moving Consumer Goods (FMCG) category and with companies such as One Harvest (prepacked salads and fruit), but less so in produce possibly due to the skills needed to achieve this, the perishable nature of most produce and the relatively large number of lines. Companies such as Perfection Fresh, is an example of a company who has assumed category management responsibilities on behalf of a major supplier.

6.5 MSC Fresh Produce Business Strategies

6.5.1 DISCUSSION ON MSC STRATEGIES

Woolworths has been acknowledged by industry as the leader and pace setter in the development of the fresh produce category to date. According to an industry source, the "Fresh Food People" brand has assisted Woolworths to obtain up to 35 per cent of the fresh produce category sales. The key drivers to this position as industry leader are seen to be:

- Adoption of proven international retail marketing strategies;
- Professional retail formats;
- Stronger focus on delivery of service and quality of produce in comparison to competitors;
- Skilled staff; and,
- Development of a product sourcing policy leading to a generally shorter chain length earlier than their competitors.

From approximately 2002 to 2005, Woolworths position as 'king of fresh produce Retailers' had been under threat as both Coles and Independent Retailers successfully clawed back market share. This rejuvenation was driven by a number of factors including:

- Historically a pricing policy of Woolworths providing higher than industry standard gross margin returns which has allowed others to be more competitive in terms of price;
- A loss of key staff to competitors;
- A perceived lack of innovation / change of formats at Woolworths retail level;
- Adoption by Coles of a model very similar to that of the 'Woolworths' model.

Woolworths through Project Mercury sought to provide a new 'edge' to fresh produce retailing (and in other sections of the Woolworths business as well). The core elements of these initiatives were:

1. <u>Logistics</u>: Rationalisation of the logistics model. Firstly, preferred suppliers were to be given access to the right to use Woolworths contracted logistics Providors to transport produce. This was expected to deliver considerable savings across the chain. This initiative has not progressed to fresh produce as we understand that the operation of the model was considered to be too risky.

2. <u>One Touch Initiatives</u>: Shelf-Ready Trays – By January 2005, Woolworths indicated to suppliers that they wished all goods, including produce, to be supplied in shelf-ready trays. Goods were to be able to be put on and taken off display in the carton / tray that it is supplied in. This initiative sought to reduce the cost of labour associated with the current processes associated with stacking and unstacking of shelves. This initiative whilst slower in adoption than originally intended has now been fully rolled out we understand. Coles however matched the initiative through the introduction of its Returnable Plastic

Crate (RPC) program. In addition, initiatives such as "Ripe 'n Ready" especially associated with pre-packing will reduce the level of wastage that occurs in certain products eg. Avocados, kiwifruit etc.

3. Supplier Rationalisation: Woolworths committed to continuing to drive the reduction the number of direct delivery suppliers and number of Wholesalers / Brokers who supply produce. Coles have effectively matched Woolworths in terms of this strategy.

4. Private Label Branding: Mercury confirmed that Woolworths were to increasingly drive the development of a house branding strategy. This also is in place but again this has been matched by a similar strategy within Coles.

6.5.2 IMPLICATIONS OF MSC ONE-TOUCH & RPC INITIATIVES

The Woolworths' 'one touch' initiative and Coles Supermarkets RPC program have both had a profound effect on the value chain. These implications have included:

1. Packers having to develop a whole new range of packaging which may or may not be aligned with packaging supplied to other customers. This has frustrated efforts towards achieving industry packaging standards. Further it has the potential to add significantly to costs of compliance by producers and packers.

2. Produce that is rejected by either MSC, is then subject to heavy discounting by other purchasers as the product is either known to have been rejected by Woolworths or is in an unsuitable packaging format.

3. Resulted in the rationalisation of suppliers, as some suppliers determined the new packaging requirements to be too onerous and / or expensive to comply with.

4. In some, the converse of (3) has occurred. Some suppliers have seen the opportunity to become more committed to the MSC. Further, the MSC have become by necessity better at providing more complete information about supply in particular, as well as quality standards.

5. May reduce the role of local Woolworths buying officers, as supply programs become more centrally controlled and direct.

Over time the One-Touch / RPC initiative may support the development of a new category of packer, whereby a company may pack product delivered in bulk by suppliers. These businesses may be located close to the source of purchase, i.e. a metropolitan centre. This type of model is similar to that which exists in the United Kingdom, with the services provided by Mack Multiples and similar, and allows for a high degree of responsiveness by the packer and supplier to changing levels of demand.

6.5.3 COLES AND IN-HOUSE CONSOLIDATORS

Both C&S Global and Costa's were examples of this type of Consolidator. Both these parties acted as an In-House Consolidator for Coles. They were both paid 4 per cent of the 'sell in' price. Industry sources suggest the procurement relationship which were terminated in the last 12 months was done as Coles did not consider the service provided enough value to Coles. Coles had already invested in procurement personnel and so 'adding' the basket of produce these Consolidators handled could be achieved at a cost lower than what they were paying. Further, sources suggest that were concerned they were getting 'too far away' from their suppliers, a situation that did not wish to continue.

6.5.4 COLES DISTRIBUTION CENTRES

Coles Supermarkets have announced that by 2012 that all fresh produce will be distributed from the new refrigerated / air-conditioned distribution centres recently or about to be built in each state.

This will result in Costa's and C&S both losing their current contracts to provide logistics and distribution services into stores.

The new facilities will be leased to a contracted operator with tenders for these services having recently been agreed to for at least two of the distribution centres.

By developing state-of-the-art distribution centres designed to handle all Coles Supermarkets grocery products, Coles has an expectation to significantly reduce costs in logistics and distribution whilst at the same time providing an improved quality offering to consumers through better cool chain management.

Further, Coles has recently announced a revised pricing structure for distribution centres. With the exception of Victoria the charge has reverted to a per unit charge as opposed to a percentage charge. Growers and Consolidators suggest that a per unit charge more accurately reflects the costs associated with logistics and distribution. A percentage charge (on the delivered in price) unfairly disadvantages higher value per kilogram products against lower value prices. Since the final retail price include the distribution centre cost the end price paid by consumers disadvantages the high value products (in comparison to lower value products). Per unit charges are more equitable as the cost of handling a box unit is the same no matter the product that it contains.

The revised pricing distribution centre charges, which became effective on March 3, 2008 are presented below in Table 10.

Table 10: Coles Distribution Centre Charges, 2008.

Location of Distribution Centre	Operator	<March 3, 2008 Fee	>March 3, 2008 Fee
Western Australia	Costas / Coles Supermarkets	10% of sell-product value	$1.28 (Coles), $0.25 (Costa's)
Victoria	Costas	10% of sell-product value	10% of sell-in product value
Tasmania	Costa's	10% of sell-product value	$1.86
Queensland	Carter & Spencer	10% of sell-product value	$1.66
South Australia	Mercorella	10% of sell-product value	$1.38
New South Wales	Costa's	10% of sell-product value	$1.08

Source: Confidential

The distribution centre fees are paid directly and in-full to the contracted operator.

6.5.5 WOOLWORTHS DISTRIBUTION CENTRES

Woolworths DC's are owned and operated by Woolworths. Each DC is regarded as a profit centre, with revenues required to invest new infrastructures and technologies in order to enhance the management of the cool chain whilst ensuring this occurs at the least cost.

Our understanding is that the fees that Woolworths 'charge' itself are lower than the Coles charges.

6.5.6 IMPLICATIONS OF THE COLES STRATEGY

The implication of the Coles strategy on horticultural producers can be summarised as follows:

1. An increasing focus by Coles to have reduced numbers of suppliers and less of a focus on dealing with the wholesale sector for supply.
2. Increased numbers of direct relationships with Grower Consolidators who can deliver to the requirements of Coles and share their 'vision' for the future.
3. Reduced opportunities unless part of a consolidation network for producers to become Coles suppliers.
4. Increased opportunities for 'forward thinking' suppliers to develop a lasting relationship with the Coles network, through supply, logistics, product and marketing innovation and support.

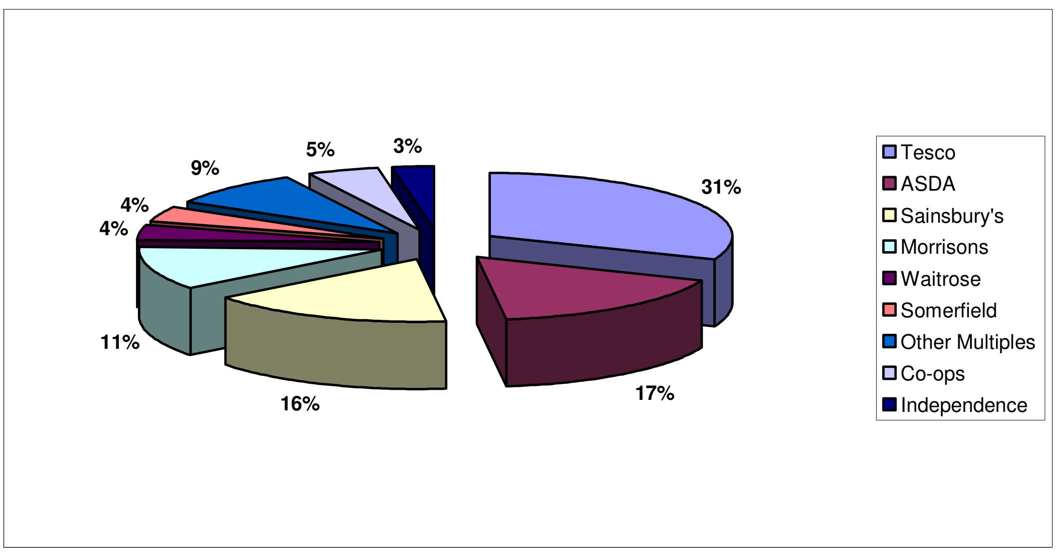
6.6 UK Retail Chains

6.6.1 COMPARISONS WITH UK RETAIL GROCERY CHAINS

In 2007, the four largest retail chains in the UK accounted for 75.6 per cent of sales (TNS, 2007). The competition amongst the UK sector is immense even with this level of concentration. It is generally felt within the Australian food industry that UK Supermarkets are the leaders in trends and in fact are somewhere between 5-10 years ahead of what is occurring in Australia.

The 12-week market share data for the MSC in the UK is presented in Figure 8.

Figure 8: UK Grocery Market Share, 12 Weeks to 25 March, 2007



Source: TNS, 2007.

Analysts state that in the 1990's the focus by UK Retailers was in the development of efficient and effective supply chains, through collaboration with their customers and suppliers. The focus was on reduction of cost and increasing efficiencies in procurement. However, all Retailers did the same things so that now each of them have what is generally regarded as some of the leanest produce supply chains in the world. As a consequence Retailers are increasingly moving towards strategies that enable them to differentiate their businesses from others not just based on price. Some of these initiatives include:

- Increasing focus on use of loyalty programs; and,
- Private label branding providing not one but multiple offers based on quality perceptions.

The increasing emphasis on private label has in itself certain risks if the product fails in terms of food safety or 'performance'. As a consequence Retailers are now increasingly investing or driving down the chain initiatives that reduce risk though tighter / more stringent food safety program and through traceability systems minimise response times to crisises. Our discussions highlight that within the next two to three years crisis and risk management will become key focal points of MSC and Other Supermarket chains.

6.6.2 PARADOX OF POWER

In UK food retailing following the considerable rationalisation of the supplier base during the 1990's and earlier part of this decade, the concept of the Paradox of Power evolved between Retailers and suppliers. In effect, the Paradox of Power refers to the situation where retail chains have invested enormous sums of money in the development of logistical, communication and distribution systems with few suppliers, that the Retailer does not have the ability to move away from that supplier as the costs and risks of doing so are too large. For instance, a supplier through having working 'within' the Retailer supply chain understands:

- exactly what it is that Retailer requires in terms of its product;
- how it must be delivered;
- in what formats it must be presented;
- what product support, merchandising and demand creation strategies are required;
- how to foster and develop relationships with the suppliers supplier; and,
- what the Retailer is looking for in the development of innovative strategies.

And further and possibly most importantly of all, the supplier (Consolidator) or in some cases category manager is the one who has access to the supplier's supplier.

As a result the Paradox of Power paradigms suggests that whilst the Retailer may originally have been the most powerful in the bargaining ability, through strategies that they have developed i.e. Chain integration, supplier rationalisation, the balance of power has shifted strongly towards the suppliers or Consolidators of the chain.

One senior MSC executive has commented that for a number of product lines they are concerned that the number of Consolidators who have the capacity and capability to work with them are becoming so few that they believe they are increasingly going to be placed at a disadvantage in supply negotiations.

6.7 MSC Margins

6.7.1 MARGIN ANALYSIS

Both MSC expect produce managers to generate an average gross margin on total annual sales of between 32-37 per cent.

The gross margin percentage per product varies due to a number of factors including:

- Levels of waste (higher wastage levels results in a higher target gross margin);
- Risk associated with the product in terms of potential need to apply discounts to sell stocks;
- Competitiveness of the product. Is the product one that consumers actively apply price comparisons to between stores eg. Stonefruit.; and,
- Product shelf life. Factor directly contributes to wastage levels (longer shelf life, more likely a reduced margin is acceptable).

Sales volumes for a particular line are not a factor in determining individual product gross margins.

From this gross margin a store manager is permitted a Variance Allowance of between 9-11 per cent. The Variance Allowance is expected to cover the difference between the dollars spent on purchasing the product in compared to what it is sold for.

As a consequence the net margin (before head office and other non-store costs) for a produce department to be in the range of 22-28 per cent.

Whilst this submission has been able to view defining figures, the industry sources suggest that the average net profit (after all costs) from produce at between 15-16 per cent of the sale value of the product to the consumer.

As a consequence the net margin (before head office and other non-store costs) is expected in a produce department to be in the range of 22-28 per cent.

Whilst this submission has been able to view defining figures, the industry sources suggest that the average net profit (after all costs) from produce at between 15-16 per cent of the sale value of the product to the consumer.

Retail observers conclude there has been an increased focus by MSC (and other produce Retailers as well) to 'fix' retail prices at the individual store level. This view is built on the belief that consumers do not wish to see extreme fluctuations in price movements associated with produce and in particular 'staple' lines, eg. apples, oranges, tomatoes etc. Whilst prices for these types of products do move with the general trend of the market, they do not respond as 'elastically' to price movements at the wholesale level. The impact of this is that some weeks, store margins may vary considerably depending on the wholesale prices.

Store managers may seek to achieve 'super' margins on other produce lines that may not require their prices to be 'fixed'. This may occur for lines that either have a fixed level of demand or are not those types of lines for which shoppers may 'change stores'.

As a consequence suppliers of certain lines may see differences between retail prices and net sales returns to Growers well in excess of what may expected in a 'typical' gross margin model as presented in Table 11. That said it is also equally possible that suppliers (if they cared to observe such things) may see differences well below what typically may be expected.

Table 11: Example of Revenue and Cost Breakdown for Bananas (13kg net box) Sold to Coles Victoria

Description	Per Carton	Per Kg
Net Price Returned to Grower	**$16.90**	**$1.30**
Plus: Freight MSC Rebate (4%)	$2.30 $0.80	$0.18 $0.06
Sell Price from Grower to MSC	**$20.00**	**$1.54**
Coles Distribution Centre Charge	$2.00	$0.15
Sell in Price to Store	**$22.00**	**$1.69**
MSC Store Gross Margin (35% Margin = 54% Mark Up)	$11.84	$0.91
Retail Sell Price	$33.83	$2.60
% Mark Up from Grower Gross Price		100%

Source: CDI Pinnacle Management

Further, some Suppliers would argue that a policy of 'differential margin setting' may be inequitable to them and Growers depending on the type of commodity that they produce.

6.7.2 DISCUSSION ON MSC MARGINS

The subject of variations or differences between what the Grower and chain intermediaries receive has been the subject of regular and constant media attention and as a result has led to the conduct of this enquiry.

HAL considers that frequently the media plays a role which seeks to generate a situation of 'us and them' which we consider not to be of advantage to anyone. For instance, a number of examples have shown that the reason why extraordinarily large differences in prices existed was because the qualities of the product being sold were different from what was being supplied by the Grower. Other reasons why 'super' margins may be seen to be being incurred were discussed in Section 6.7.1.

<u>HAL'S conclusions are that whilst it will not be possible to prevent 'sensational journalism' the whole supply chain needs to be able to be presented with accurate, comprehensive and independently verified information pertaining to costs and margins from Grower to end user. Presently this type of information is not available, with anecdotal, single party discussions only being used to reach general conclusions.</u>

<u>The timeframe to prepare this submission has not allowed HAL as the representative of the horticultural production end of the chain to prepare detailed data on the subject. Frankly, HAL does not believe it is possible to undertake such an activity without the willing participation of Growers, Consolidators, Mid-Chain and Retailers (MSC', other Independent Supermarket Chains and Independent Greengrocers).</u>

<u>As has been noted by HAL, the ACCC were able to reach definitive conclusions on margins in the supply chain in the red meat industry through the "Examination of the prices paid to farmers for livestock and the prices paid by Australian consumers for red meat. We (HAL) wish to offer our assistance in the conduct of a study during the course of this enquiry.</u>

<u>Further, our suggested approach would be that an Independent party be commissioned by the ACCC to conduct the investigation with its Terms of Reference agreed to by a Steering Committee appointed by ACCC. The enquiry should focus around a basket of horticultural products which exhibit a variation of characteristics (staple, non-staple, perishable, non-perishable, imported, exotic for example). The results of the investigation we believe</u>

should be made publicly available although the identity of contributing parties should be subject to confidentiality.

Actions such as this will then allow an informed debate between value chain members, industry organisations, government and consumer organisations. It will also go some way, hopefully, to rebuilding the ties between some elements of the value chain who have become disenchanted or disenfranchised with those in the retail level.

7. Independent Greengrocers

7.1 Greengrocers Competing with MSC

Recent statistics on the number of Greengrocers operating in Australia are difficult to obtain. The most recent (1999) figures showed that the number of Independent Greengrocers have declined to 1,611 from 3,670 in 1992.

These figures support the view that the Independent Greengrocer is competing strongly with the MSC and other Independent food chains. In fact one Wholesaler / Retailer commented that although there is a high degree of variability with regards to profitability between Individual Greengrocers, overall the last decade has seen strong profits being generated by highly professional, well positioned Independent Greengrocers.

The general view is that 'good' Retailers are comparatively better than MSC at:

- Presenting products in a more appealing way;
- Having lower levels of wastage;
- Having a finer attention to detail and experience in regards to selecting high quality produce;
- Lower labour costs (as many use their own labour) but this may be countervailed by having more staff at registers and involved in the presenting of stock;
- Lower management overheads; and,
- Being able to supply better quality produce as their supply chains are shorter.

Conversely, it is generally acknowledged the MSC are able to achieve comparatively lower costs than Greengrocers in respect of:

- Purchasing directly from Individual Growers or Consolidators rather than have another additional transaction cost to the Wholesaler or Broker.
- Through one-touch packaging achievement of cost economies at the retail store level in terms of costs of stock management.
- Through one-touch packing achievement of some cost economies in the purchase of product as packers are able to pack for produce for less.
- May in the case of regional Greengrocers have a cost advantage in terms of cost of freight movements from DC or market.

As a consequence of these factors it is apparent there is a strong level of competition between MSC and other chain Retailers and Independent Greengrocers.

7.2 Supply Models and Strategies

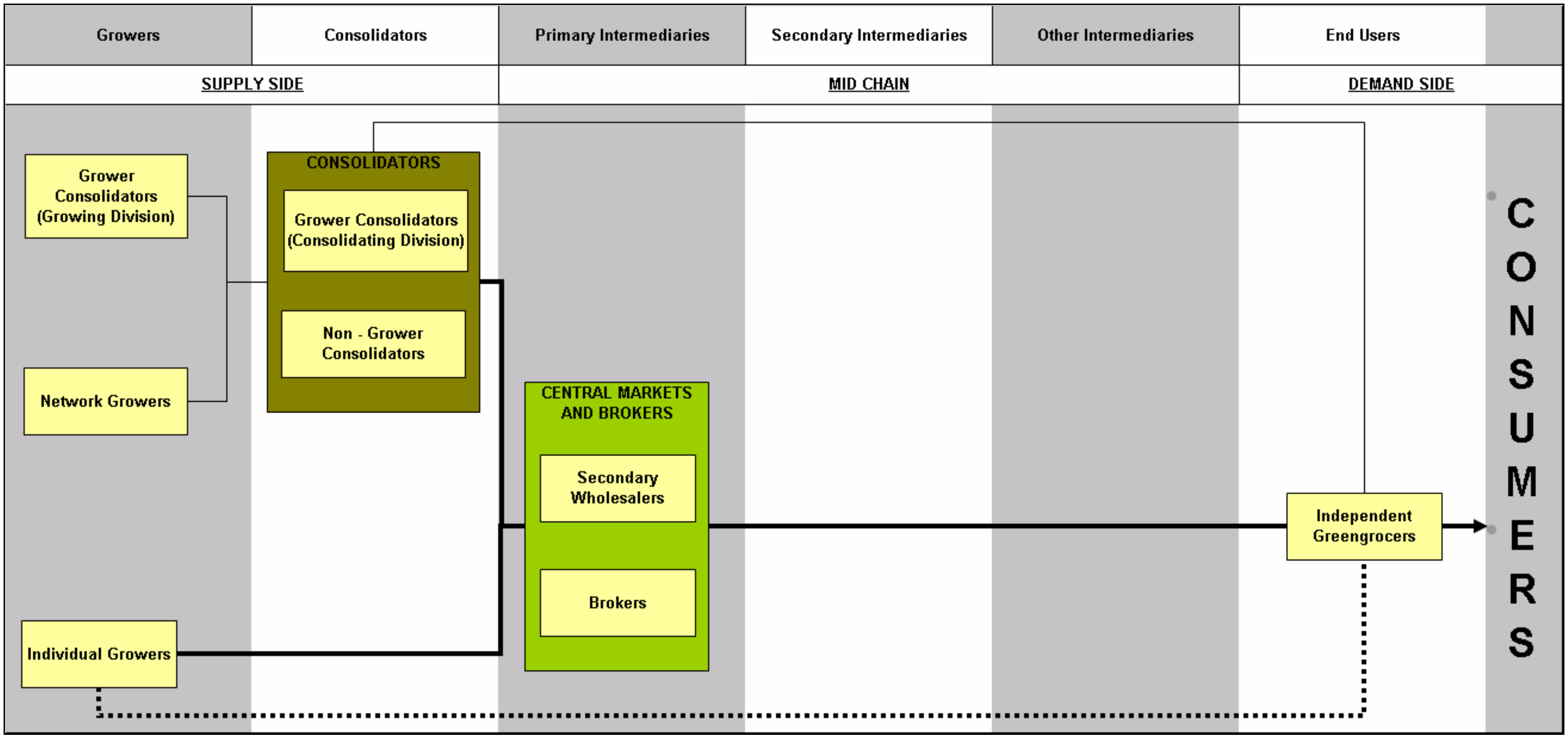
7.2.1 METROPOLITAN GREENGROCERS

Principally, Metropolitan Greengrocers source fruit and vegetables directly from the Central Market. Larger independent or small chains of Independent Greengrocers may also deal directly with a Consolidator. This would be more common in Sydney and Melbourne where there are a number of smaller Greengrocer chains eg. Harris Farm Markets.

An alternative sourcing arrangement may involve direct negotiation with Individual Growers, particularly where they are close by / local to the Greengrocer. Overall though the number of transactions of this type are very minimal and do not warrant further discussion.

Diagrammatically, the structure of the value chains that supply metropolitan Greengrocers is depicted in Figure 9.

Figure 9: Australian Supply Chain for Supply of Horticultural Produce to Metropolitan Greengrocers.



Source: CDI Pinnacle Management, 2008.

7.2.2 REGIONAL GREENGROCERS

In respect of Regional Greengrocers the supply model becomes a little more complex. Whilst the volume of product that may be sourced directly from Growers may increase in certain locations (where there is nearby farming), it is not possible for any Greengrocer to purchase all of their requirements within their own local region. In the absence of regional wholesale markets which were prevalent up until the 1970's and 1980's regional Greengrocers are 'forced' to source product from the nearest Central Market.

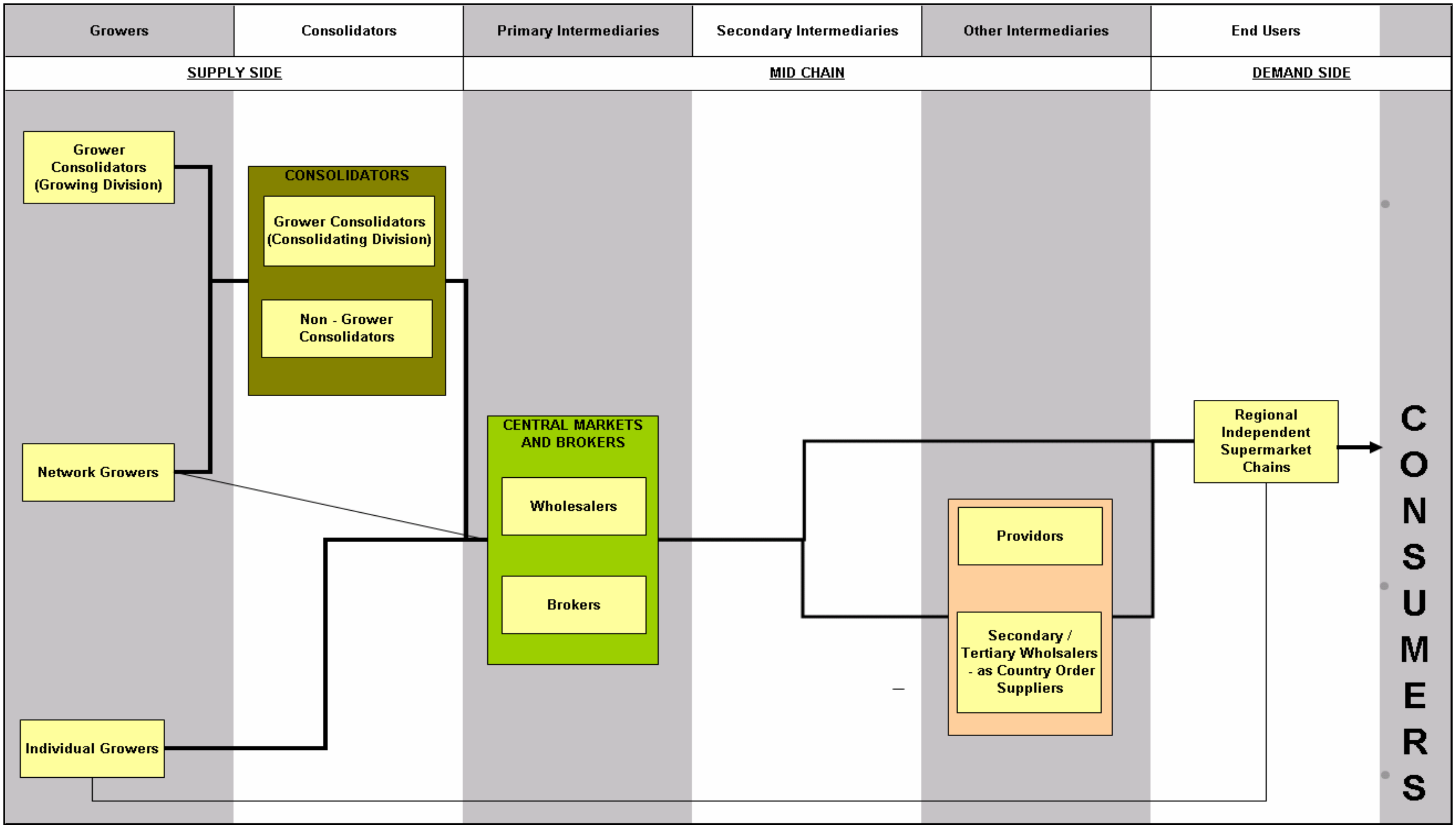
Regional Greengrocers in dealing with Wholesalers and Brokers in the Central Markets have three options in respect of purchasing. These are:

1. Remote Purchasing. Greengrocer orders and has supplied products from a select group of Centra Market Wholesalers who the Greengrocer is confident will supply goods to the required qualities. This strategy relies on the Greengrocer being able to generate enough 'market knowledge' to know that the prices paid are fair.
2. Country Order Suppliers: The Greengrocer orders their requirements from a COS who is located in the Central Markets. The COS then purchases the order, assembles it and freights the product to the Greengrocer.
3. Buying Collective: A group of Greengrocers in a region will appoint a single buyer (may also be one of the Greengrocers) who will then travel to the Central Markets to purchase products on behalf of the group. The buyer will then either organise freight on behalf of the group or alternatively the product may be transported in a vehicle owned by one of the Greengrocers.

No matter which strategy is pursued the location of the Greengrocer will result in the 'buy-in' price to the store to be on average higher. Further, depending on the integrity of the cool chain the Greengrocer may also be have higher levels of waste. In combination these factors will contribute to a higher average price to consumers.

The supply chain for regional Greengrocers is presented in Figure 10.

Figure 10: Australian Supply Chain for Supply of Horticultural Produce to Regional Greengrocers.



7.2.3 PURCHASING FROM CENTRAL MARKETS

Traditionally, MSC buyers and Greengrocers walked the market on a daily basis purchasing their needs. With the increasing trend by MSC to greater and greater levels of direct purchasing the Central Markets suffered a downturn in the number of buyers who attended the markets. This was further exacerbated by the reduction in Greengrocer numbers in the 90's. Some painted a picture of doom for Central Markets however over the last five years as Greengrocer numbers have stabilised the Central Markets remain a critical element of the value chain. Still critically, the Central Markets are still seen as the primary price setting mechanism for produce, even with the direct relationships between Growers and Consolidators with MSC.

Over time however the purchasing processes used by Greengrocers have changed. Some of these changes include:

1. Direct Ordering the day / night prior to delivery. Some Greengrocers will order goods the night or day before delivery to ensure supply access. Price may be negotiated at that point or alternatively the next day. By doing this Greengrocers are able to reduce the time spent in the market and to more effectively manage the cool chain.

2. Reduced number of days attending the market. Traditionally, Greengrocers attended the market five days of the week. It is more common now that this number is reduced to three days. The impact of this is that Growers must target their delivery days to meet the days (generally Monday, Wednesday, Thursday) Greengrocers are attending the market.

3. Greater average focus on quality. Many of the Greengrocers in the 90's who left the industry were focussed on the low cost / low quality end of the market. Therefore Growers who had on average poor quality product still had a channel to which they could sell their produce. Now as consumers demand higher quality product, Greengrocers must be able to access that quality the quality demanded otherwise run the risk of losing a customer. Greengrocers now are generally regarded as being suppliers of higher quality produce than MSC or other Independent Supermarket chains.

4. Brand Focus / Supply Consistency: As (3) becomes more and more of a focus, Greengrocers are increasingly focussed on the Growers brand that a supplier has available and will tend to come back to that brand if it satisfies their requirements. Price becomes less of a focus in return for quality of produce and convenience associated with its purchase. If however a produce line is not available on a regular basis, the Wholesaler is less able to market the brand effectively. As a result, Wholesalers are increasingly seeking high quality, longer lines of product from recognised Growers in order to meet the needs of its customers. Of less interest to Wholesalers are Growers who supply small lines of produce, unless they are of a very high and consistent quality.

7.3 Pricing Models from Suppliers

Greengrocers, particularly those located immediately adjacent to MSC, compete fiercely with them to achieve and maintain market share. Both groups regularly monitor the pricing of the others products. This may then lead to adjustments in pricing at MSC individual store level that are not consistent with general state based pricing. There are a number of well documented examples where a MSC might discount product below the cost of supply or at least sacrifice store margin to attempt to gain market share. This is generally done on only a very small number of lines at any one time.

Some of the strategies employed by Greengrocers to offset attempts by the MSC to achieve greater store market shares are:

1. Matching prices with the MSC on a small basket of staple fruit and vegetables which based on research consumers are more likely to change suppliers for. These 'buying specific fighting stocks' may include bananas, lettuce, mushrooms, tomatoes.

5. Providing products of a superior quality.

6. Provision of superior quality service.

7. Providing shopping environments which are more appealing to the shopper.

8. In some instances, providing store or store group loyalty programs.

7.4 Store Profitability

In general, our initial discussions with Independent Greengrocers indicate that whilst competition amongst themselves and with other food Retailers is fierce, good professional operators are earning 'acceptable' returns. What is defined as an acceptable return was not able to be determined and should be the subject of further research, however our investigations suggest that good Independent Greengrocers are returning in the range of 12-20 per cent EBIT.

Information provided by an eastern seaboard Independent Greengrocer, with a turnover of close to $3 million per annum and located immediately adjacent to a MSC store confirmed that their EBIT percentage was 18 for the last financial year. This store which had been operating for a period of 11 years indicated that the trading margins that they received was dependant on:

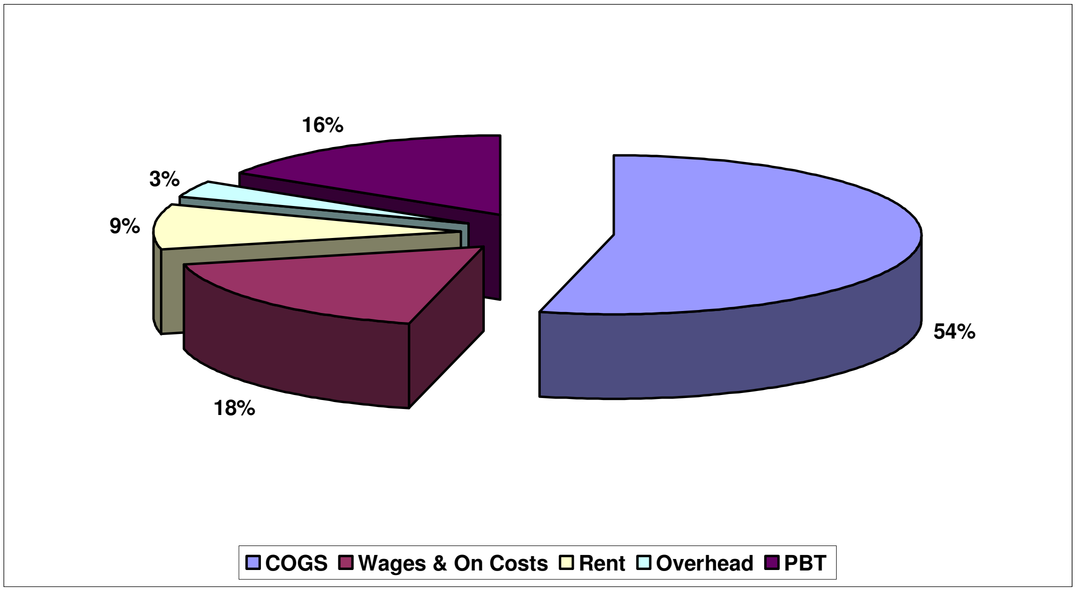
1. The state of the economy.

2. The price of produce on average across a whole year. The Retailer confirmed that his business makes more money when prices are consistent across a year rather than very low or very high. Price consistency is generally tied to environmental conditions and how it influences the supply / demand balance.

9. The quality of product that they can offer.

Wages, rent and COGS are virtually the sole costs associated with the operation of a Greengrocer. This Greengrocer indicated that as percentage of costs the split between the major cost items were as described in Figure 11.

Figure 11: Major Business Cost Centres for a Single Independent Greengrocer.



Source: Confidential

A number of Retailers indicated that the competition between their businesses and others is not their greatest concern currently. Their main concerns revolved around the following:

1. Rent / lease costs. Particularly where the Greengrocer is located in a shopping centre, lease costs are generally running at more than inflation, with the minimum annual rate increase quoted at 3 per cent and up to 5 per cent.

2. Wages. Whilst the Retail Industry Award indicates that casual hourly award rate has increased 6.7 per cent in the last three years, the actual growth in wage rates has been more than this due to the fact that they are having to pay higher rates of pay to attract staff.

3. Staff availability. Due to the requirements of having personable staff and people who are prepared to work in a fruit shop the pool of available workers is extremely small. One Greengrocer commented that they had been looking for three weeks to employ a senior staff member without success.

7.5 Indicative Store Margins

Discussions with a narrow range of Independent Greengrocers indicated a range of average gross margins based on the 'buy-in' and retail sales prices that they received. This information is presented in Table 12.

Table 12: Gross Margins for Basket of Fruit & Vegetables, 8/3/08.

Product	Purchase Price - $/kg	Retail Price - $/kg	% Gross Margin	% Markup
Capsicum	$3.25	$5.98	30.1%	84.0%
Bananas	$1.85	$2.95	38.3%	59.5%
Beans (handpicked)	$7.00	$8.99	14.3%	28.4%
Potatoes	$1.10	$1.98	44.4%	80.0%
Grapes	$3.80	$5.99	36.6%	57.6%

Source: Confidential, Information compiled on 5/3/08.

The majority of the gross margins quoted are on average around 35 per cent. What is interesting to note is that handpicked beans which are currently expensive compared to normal pricing is providing a gross margin of 14.3 per cent currently. Both MSC and Independent Greengrocers commented that when purchase prices for fruit and vegetables are well above the normal price paid, the Retailer can not apply a normal percentage gross margin to calculate the retail price. If they did they commented that sales would diminish dramatically as consumers would switch away from the buying of that product.

8. Other Supermarket / Grocery Chains

8.1 Structure of the Sector

Independent chain store or Independent Retailers are seen by industry as not being as advanced in the development of 'direct' supply relationships with Growers and / or Consolidators. This in part is seen as a timing issue as, until recently, these Retailers lacked access to centralised receival and distribution centres for fresh produce. In addition, Independent Retailers and Greengrocers tend not to have the scale of centralised purchasing necessary through to be of interest to large Grower Consolidators. Additionally, a number of these companies were comfortable with sourcing produce from the wholesale market on a normal trading basis.

Many independent chain store Retailers do not have a focus on the fresh produce category. In major urban centres consumers tend to use them for convenience or 'top-up' shopping. In regional Australia on the other hand they are seen as more central by consumers as the MSC may not be located in their town. It is apparent in metropolitan centres the fresh produce category has less importance than in regional centres. It must be noted however, that since these stores are independently owned the level of focus on fresh produce does vary.

There is limited evidence of the development of direct supply linkages between Independent Grocery Retailers and Growers, with most relationships involving the presence of a Wholesaler. Industry sources suggest that this is not likely to change greatly in future. Increased direct dealings with Growers will require the development of more infrastructure on site, a situation which many space poor operations can well not afford.

8.1.1 ALDI

ALDI commenced operations in Australia in 2001 with the establishment of its first store. The operation currently has a total of 170 stores located in NSW (principally), the ACT, Queensland and Victoria. Each store is centrally owned.

ALDI is a global grocery Retailer who does not offer fruit and vegetables to their customers, with the sole exception of Australia. Whilst not a primary focus of the Retailer with the growth in store numbers the company is becoming of increasing importance to Australia's horticultural industry.

In Australia, ALDI currently only sources 20-25 fruit and vegetable lines, and does not see produce as a central plank to its marketing strategy. ALDI currently demands 'house label' packaging for virtually all lines.

8.1.2 IGA

Presently, 1,256 IGA branded stores are located in all mainland Australia states as well as the ACT. There are a variety of store formats across the country including Super-IGA (larger format stores focussed on both convenience and everyday shopping), IGA and IGA-Express (purely convenience focussed). The footprint that each store has for fruit and vegetables varies depending on the preference of the owner. Generally though as the store has a smaller footprint there is less of a focus on produce. Further, regional operations will have a greater focus on produce than metropolitan ones although this is dependant on the existence of the MSC in the vicinity.

8.1.3 FOODWORKS

Foodworks emerged in November, 2004 from the merger of Foodworks Supermarket Group Ltd and Australian United Retailers. Former store brands which are now trading under the Foodworks brand include AUR, Foodstore, Foodworks, Buy Rite, Cut Price, 727, Rite-Way, Food-Rite, Tuckerbag and Food-Way (www.foodworks.com.au, Visited 8/3/08).

Most recent estimates for Foodworks store numbers are 710.

Foodworks stores have a variety of store sizes which in turn have a variable focus on the stocking of fruit and vegetables. The smallest convenience stores may stock products in a single display or refrigerator up to operations which have multiple display formats.

8.1.4 OTHER CHAINS

Beyond ALDI, IGA and Foodworks the other Supermarket banners currently in Australia with the most recent estimate of their store numbers are:

Figure 12: Estimated of Total No. of Stores Held by Smaller Independent Banner Operations.

Banner Store	Total No. of Stores
Metcash	829
Pick ‘n Pack	70
Spar	269

Source: National Association of Retail Grocers in Australia

8.2 Nature of Individual Supermarket Supply Chains

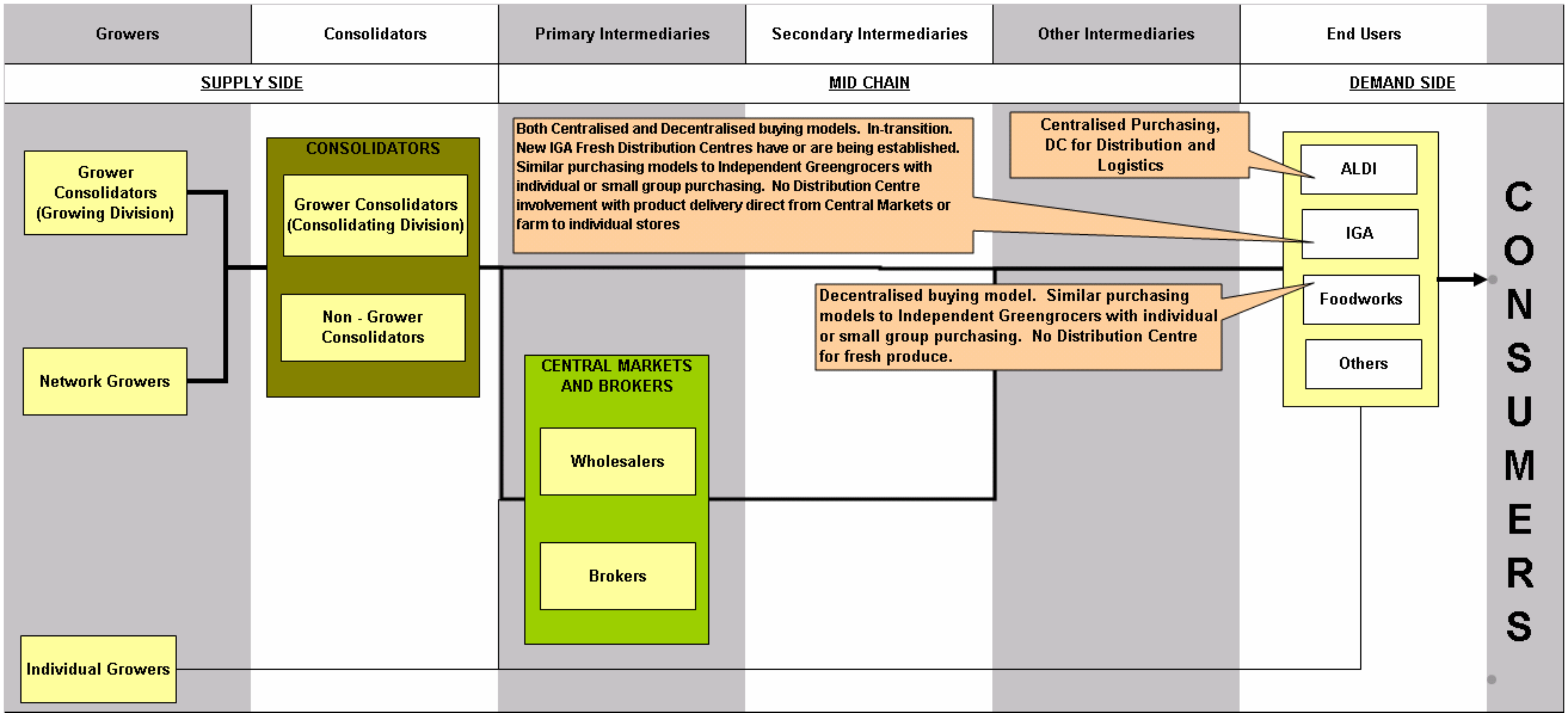
Purchasing of fruit and vegetables by each of the major “Other” Supermarket chains varies considerably between each. These variations are summarised in Table 13. Further a visual depiction of the “Other” Supermarket Chains is presented in Figure 13 immediately below Table 13.

Table 13: Characteristics of Principal "Other" Supermarket Chains Purchasing Policies.

Characteristic	ALDI	IGA	Foodworks
1. Centralised Purchasing	Yes	Yes – emerging with development of IGA Fresh.	No
2. De-Centralised Purchasing	No	Yes – store owners have option to opt out of IGA Fresh. Refer to Section 7.2 for relevant description of procedures.	Yes – individual or small group buying. Refer to Section 7.2 for relevant description of procedures.
3. Accredited Vendors	Yes – principally located in major wholesale markets.	No	No
4. Supply Programs	No but under discussion with vendors.	No	No
5. Pricing	Lowest price offered by vendors subject to quality standards.	Lowest negotiated price with suppliers.	Lowest negotiated price with suppliers.
6. Direct Sale & Delivery to Store by Regional Suppliers	No	Yes – depends on store preference.	Yes – depends on store preference.
7. Produce Format	Strong emphasis on pre-packing.	Principally loose..	Principally loose.
8. Rebates deducted	No	No	No
9. Discounts or Listing Fees deducted	No	No – not for fresh produce	No – not for fresh produce.

Source: CDI Pinnacle Management, 2008.

Figure 13: Australian Supply Chain for Supply of Horticultural Produce to "Other" Supermarket Chains.



Source: CDI Pinnacle Management, 2008.

8.3 Other Supermarket Pricing & Margin Strategies

The timing associated with the preparation of this submission did not provide enough time to investigate fully the pricing and margin strategies that are used by the "Other" Supermarket Chains and so our observations have not been rigorously tested.

The general conclusions in respect of pricing and marketing strategies for IGA and Foodworks Supermarkets are:

1. Store gross margins <u>on average</u> are in the range of 35-45 per cent. The higher gross margin in the range applies to smaller stores who have more a convenience clientele rather than the larger / more mainstream Supermarkets who do need to compete more closely with MSC and Greengrocers.

2. Higher gross margins are necessary to support a higher average waste percentage than Greengrocers (in particular) and also MSC incur. Higher wastage percentages are particularly evident in smaller operations as unit purchase sizes may be too large for stores to clear. Further, cool chain management in smaller operations for fruit and vegetables is comparatively poor as 'back of store' is not geared to adequately temperature manage fresh produce.

3. Anecdotal evidence suggests that IGA and Foodworks have higher cost structures, particularly in respect of labour costs. Our investigations however are not able to confirm this.

4. Anecdotal evidence suggests that due to the choices associated with store locations that these Supermarkets take limited notice of the retail prices for fruit and vegetables offered by MSC in particular.

5. Anecdotal evidence suggests returns per square metre are lower in comparison to that generated through the sale of non-fresh groceries in these types of Supermarkets.

The strategy that ALDI pursues in respect of pricing and marketing is different to that of the other two Supermarkets. This is largely in part due to the general ALDI strategy of working on much lower margins than even normal MSC stores operate on. The generally accepted belief is that ALDI will work on gross margins across all groceries of 15-20 per cent. Store margins for fruit and vegetables were not able to be supplied.

However the general conclusions that were observed in regards ALDI pricing and marketing of produce:

1. They are regarded as price leaders by the MSC and Greengrocers. There prices are generally lower than that supplied by either of the other two groupings.

2. Lower prices are due in part to lower labour costs with ALDI generally representing around 6 per cent of revenue, as opposed to 12-16 per cent in MSC. There is no produce manager employed in the ALDI department. The reduced number of others, around 25, also makes stock rotation and management a lot quicker.

3. ALDI ability to supply cheaper products is in part due to their purchasing policies of not focussing on premium produce or ideal target sizes. This allows ALDI to pay prices at the lower end of the range to suppliers. ALDI makes no apology for the fact that their product is not 'glamour'. They target shoppers who wish to buy sound products at cheap prices.

4. ALDI purchasing model is minimalist in that there are few management staff involved in the purchasing of fruit and vegetables on a state basis.

5. If a similar rule is applied to margins on fresh fruit and vegetables from MSC our expectation is that the average margin on fruit and vegetables is in the range of 25-30 per cent. This view is however only based on anecdotal evidence.

9. Other Horticultural Chain Participants

9.1 Foodservice

The food service sector comprises companies that supplies food products to institutions, eg. Hospitals, retirement homes, prisons, schools, restaurants, quick service restaurants (QSR), vending, catering companies and hotels. With the notable exception of a number of the major QSR chains eg. McDonalds, Hungry Jacks, Pizza Hut etc few if any of these companies source produce direct from Growers and in many instances use an intermediary such as a Primary Wholesaler, Secondary Wholesaler or Country Order Suppliers (who in this sector may be referred to as a Providor).

In metropolitan centres the intermediary is used as they have skills associated with the purchasing of produce from the Central Markets and distribution skills direct to the customer. Generally these intermediaries purchase product on behalf of a number of food service outlets.

In regional centres an intermediary is used for geographic and logistical reasons in addition to the fact that they have skills in the purchasing of produce from the Central Markets.

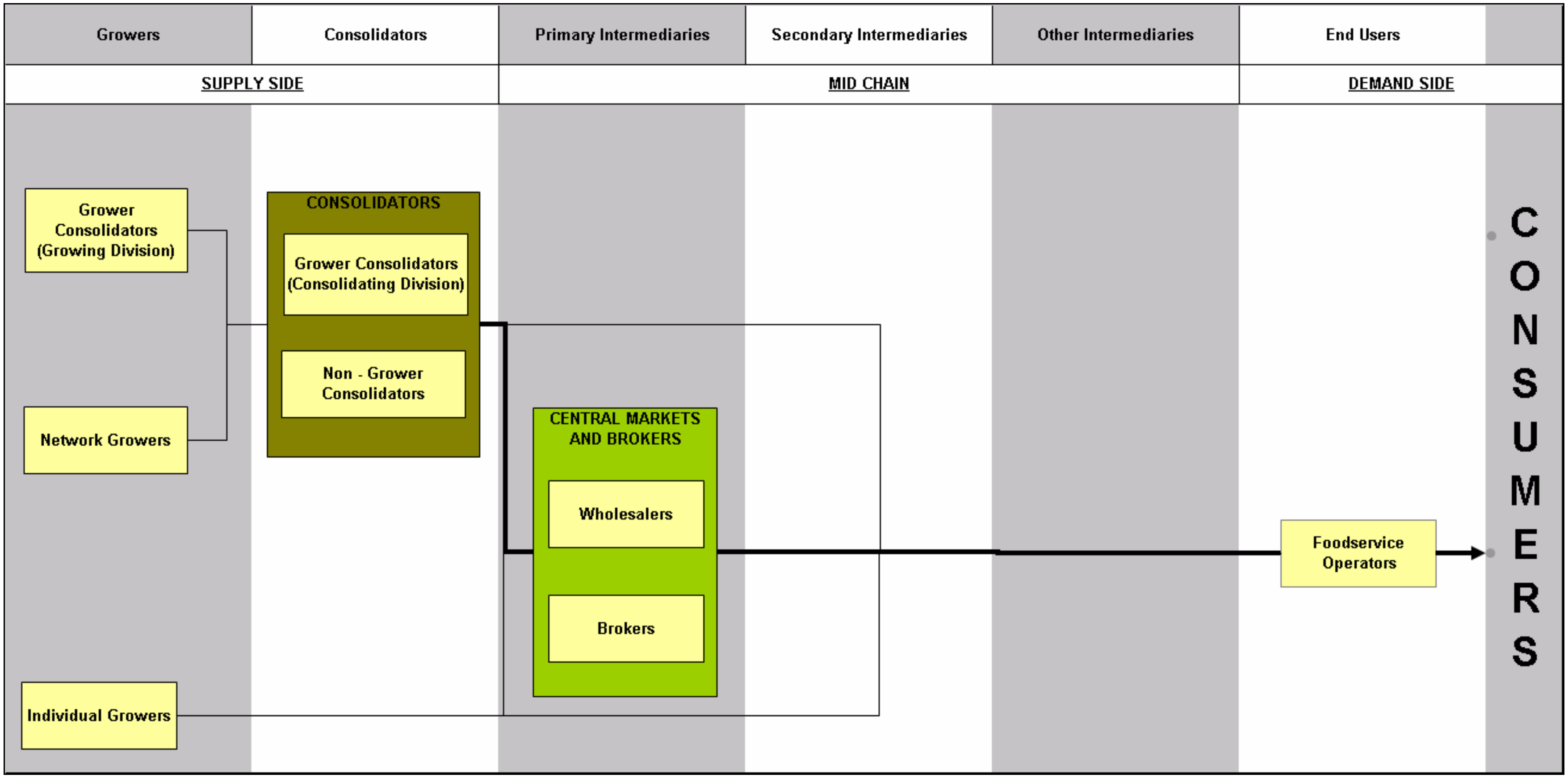
Companies such as Simon George and Sons in Queensland who act as fresh produce Providores who have operations close to the Central Markets are a good example of the type of businesses who supply this sector.

Secondary Wholesalers or Providores may undertake minimal processing of the product prior to delivery, i.e. cutting, portion control, to the companies who supply the prepared food to consumers. An example of this type of company is Vegie-Express who is based in Brisbane.

Food Processors / Value-adders supply a more finished product to the customers in this sector.

A visual depiction of the supply chain for produce supplied to the Foodservice sector is provided in Figure 14.

Figure 14: Australian Supply Chain for Supply of Horticultural Produce to the Food Service Sector.



Source: CDI Pinnacle Management, 2008.

Please refer to Section 7.2 with regards to buying strategies of food service proprietors and secondary Wholesalers as there is no effective difference in the way they transact with suppliers.

No further consideration is provided to the Food Service industry as part of this submission as they do not directly impact on this Inquiries Terms of Reference.

9.2 Processors

9.2.1 VEGETABLES

The principal vegetables processed in Australia are potatoes, tomatoes, peas, carrots and beans.

In Australia these large vegetable Processors are: Berri Ltd, Golden Circle, Logan Farm, Kraft, McCains, MasterFoods, Nestle, Simplot, Coca-Cola Amatil and Unilever, in addition to the fresh cut Processors One Harvest and Golden State Foods (GSF).

The fruit and vegetable processing industry has entities which range in size from the conglomerates and corporations as listed above to small family owned enterprises supplying a range of food service and ingredient manufacturers.

Worldwide the processed vegetable industry is dominated by a small number of conglomerates, these being, Unilever (in Australia), Simplot (in Australia), McCains (in Australia), ConAgra and Delmonte. All of these Processors as world players hold a great deal of market power in terms of their negotiations with Retailers. Further, this power extends to negotiations with Australian vegetable suppliers, as each of these companies have the ability to supply their range from outside of Australia (within the confines of freight costs). Our preliminary discussions with southern based Growers whilst acknowledging this presence of Processor market power generally take the view that they must seek all methods possible to work with that Processor in order to ensure that the products they produce are not processed off-shore.

The principal processed vegetables that are imported into Australia are canned tomatoes, frozen potatoes, frozen green peas and other vegetable mixes that are either frozen or preserved. Both imported tomatoes and frozen potatoes account for around 50 per cent of product offers on retail shelves in MSC.

9.2.2 FRUIT

In Australia, oranges are by far the dominant fruit that is processed. Much smaller quantities of pome fruit and stone fruit are processed in the southern states of Australia, with pineapples coming from Queensland. There is a small but emerging fresh cut fruit industry (estimated industry value around $10 million) centred principally around melon, pineapple, apple and grape products.

The major orange juice manufacturers in Australia include Berri Ltd, Mildura Fruit Company and Golden Circle Ltd. There are a number of smaller Processors who focus on deliveries to local markets.

The pricing of oranges for processing has been directly dependant on the FCOJ price that is largely determined by the success or otherwise of the Brazilian harvest. This is still the case for FCOJ that is produced in Australia. However, the development of the fresh juice market, principally through MSC has provided some protection to Australian Growers with respect to the fluctuations in prices paid for oranges.

The pricing for other fruit products is dictated by the price that Processors can pay for imported materials where further processing occurs eg. Jams and other preserves, or the landed tinned price as in the case of pineapple, pome and stone fruits.

A number of the house branded tinned fruit products stocked by MSC are manufactured outside of Australia. MSC have stated that the price competitiveness of the imported product has forced them to move offshore with their purchasing requirements.

The MSC have also stated that whilst they wish to develop their range of private label fruit (and vegetable) tinned product offerings the strong brands associated with some of the Australian produced product will result in them being maintained on shelves. In particular, SPC and Golden Circle fall into this category.

9.2.3 PROCESSOR SOURCING, COSTS AND MARGINS

Our submission was not able to evaluate in more detail the principal cost centres associated with fruit and vegetable processing.

Anecdotally the maajor cost centres for Processors are considered to be:

- Capital costs;
- Raw material costs;
- Other operating costs (labour, energy, packaging, marketing); and,
- Transport inwards and outwards.

Large conglomerates such as Simplot and GSF deal directly with large, significant Growers or Grower Consolidators. Most Growers supply Processors on a seasonal agreed price per volume based on an agreed set of quality parameters (i.e. size, weight, quality, colour, level of defect). Volume contracts / agreements are used but are dependant on the nature of the relationship. For larger Processors volume agreements are frequently used (i.e. Golden Circle, GSF, One Harvest).

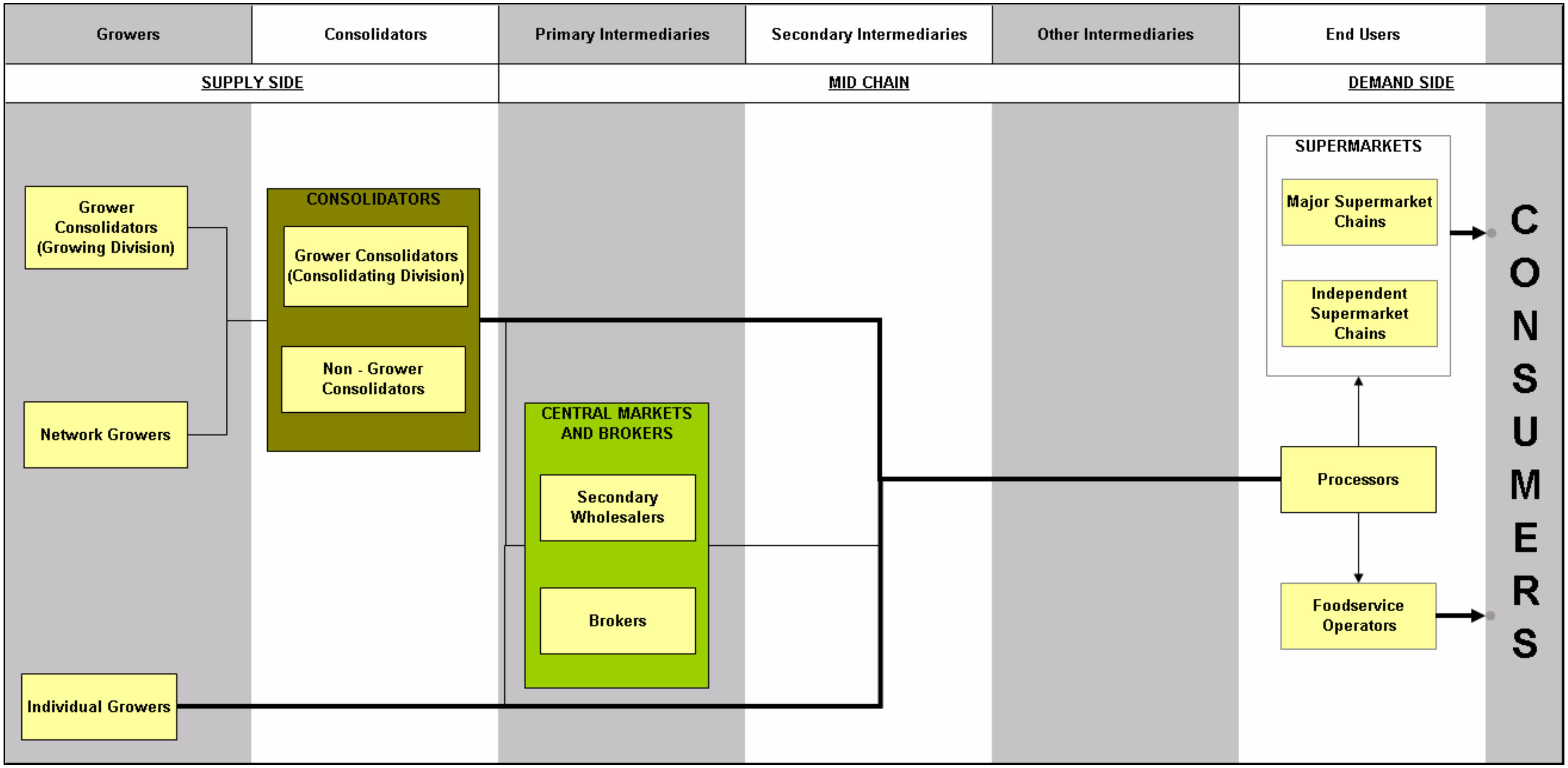
Depending on the Processor, companies such as Simplot demand product be supplied to them that is tailored to their requirements. The product supplied is not a by-product of another grading process which may have the primary focus of supplying the fresh markets. Another good example of this type of Processor is One Harvest who supply both MSC with pre-cut fresh salads (private label) and now a range of fresh cut fruits. In these examples the Processor has an active involvement in breed / variety selection, production extension and logistics.

Processors such as Simplot and One Harvest are forced to tie their pricing to the prices that they have negotiated with their customers. As a consequence, the Processor frequently works closely with the supplier in order to agree on prices and very often to identify ways in which they can get pricing. Particularly for product that is frozen following processing the industry is highly competitive as it faces competition from other Processors from overseas. Further, normally there are limited issues with quarantine further enhancing the competitive market in which these Processors operate.

Other Processors acquire product that is not suitable for the fresh market (i.e. second grade). In most instances, Processors receive product that is not to suitable for the fresh produce market. Processors of this type set pricing benchmarks to Growers based on end price received less margin and manufacturing and transportation costs. Growers have little or no input, with the one or two possible exceptions, in regards to pricing. In fact many Growers see processing contracts as a means to recover harvesting and packaging costs and overheads, and not an income stream worthy of significant investment.

A visual depiction of the supply chain for processing fruit and vegetables is provided in Figure 15

Figure 15: Australian Supply Chain for Supply of Horticultural Produce to Processors.



Source: CDI Pinnacle Management

Due to the limited timeframe in the preparation of this submission and in some cases very limited availability of relevant, up-to-date information on fruit and vegetable processing the following gaps need to be addressed:

- Collection of accurate data in respect of fruit and vegetable processing volumes in Australia and percentage share moving down particular channels.
- Collection of accurate data on returns, costs and margins received by Growers, Processors and Retailers for processing fruit and vegetables.
- Collection of accurate data
- Collection of more detailed information in respect of competitiveness of Australian processed (tinned, frozen or otherwise preserved) products with overseas products.

The impact on Australian Growers who produce fruits and vegetables for processing industries of the drive by MSC to source house brands appears to be understated and warrants detailed further investigation.

9.3 On-Line Retailing

On-line or internet purchasing of fruit and vegetables only has a limited share of the consumer market. Sydney, Melbourne and to a lesser extent Brisbane are the major centres from on-line purchasing occurs.

Companies that run on-line businesses contend that for them the business has considerable upside, as produce is paid for in advance and stock inventory turns over every day (sales perfectly match purchases). The benefits to consumers are seen to be that produce is fresh daily and due to the lack of need for high cost warehousing may be less expensive. Conversely, the transportation costs are seen to contribute significantly to the costs of produce supplied to consumers..

Industry sources suggested that on-line purchasing of fruit and vegetables only account for 1-2 per cent of the total market. Growth is currently static. It is thought that the lack of a culture to purchase on-line is due to the historical purchase preferences for consumers, in addition to the fact that consumers in Australia find it easy to transport goods home from retail stores and generally combine other activities with food shopping.

<u>No further consideration is provided to the On-Line retailing sector as part of this submission as the sector has little impact on the overall performance of the fresh fruit and vegetable industry.</u>

10. Imported Fruit & Vegetables

10.1 Products Imported

The total value of imports of fresh fruit and vegetables into Australia in 2005 (fruit) and 2007 (vegetable) was estimated at $148 million.

10.1.1 FRESH FRUIT

The principal fruit products imported and their values (CIF) for F2001 and F2005 are presented in Table 14.

Table 14: Dollar Value (CIF basis) for Fresh Fruit Imports into Australia, F2001 and F2005.

Product	$ Value Imported F2001	$ Value Imported F2005	% Change
Avocados	11	24	+118%
Kiwifruit	29	34	+17%
Oranges	17	15	-12%
Cherries	6	11	+83%
Grapes	0	19	N/a
Total	**63**	**103**	**+63%**

Source: ABS, 2005

10.1.2 FRESH VEGETABLES

The principal vegetable products imported into Australia and their values for F2003 and F2007 are presented in Table 15.

Table 15: Dollar Value (CIF basis) for Fresh Vegetable Imports into Australia, F2003 and F2007

Product	$ Value Imported F2001	$ Value Imported F2005	% Change
Garlic	6.0	12.2	+103.3%
Capsicum	4.5	9.3	+106.7%
Asparagus	3.2	6.7	+109.4%
Onion & Shallots	4.0	5.6	+40%
Tomatoes	2.7	3.7	+37.0%
Peas	1.5	2.8	+86.7%
Mushrooms & Truffles	1.0	1.2	+20.0%
Beans	0.8	0.6	-42.5%

Product	$ Value Imported F2001	$ Value Imported F2005	% Change
Others	3.0	2.4	-20.0%
Total	**26.7**	**44.5**	**+66.7%**

Source: AUSVEG (2007), Australian Bureau of Statistics

10.2 Factors Influencing Imports

10.2.1 COMMERCIAL PARTY POSITION

Both MSC and Independent Greengrocers say a potential point of weakness in their marketing strategies occurs if they do not have available the vast majority of fruit and vegetable lines. They consider they run the risk of losing a customer if they don't have a product which their operation has. Further, they contend that Australian suppliers do run the risk of losing customers if their product is not available when the consumer wants to purchase it resulting in them switching to another fruit or vegetable. The later factor HAL considers to be a tenuous view.

HAL in its discussions with the MSC and Mid-Chain identified the following reasons why fruit and vegetables are imported into Australia. These reasons include:

1. The product is not available in Australia. In many cases this may be in very short windows caused by environmental factors (more prevalent in vegetables).
2. The product may be available in Australia but not in volumes required and / or of the quality required by the MSC.
3. The price of the commodity is so high that consumers will refuse to buy the product at the prices that the MSC would have to charge. This we consider is the major source of angst for horticultural producers in relation to imports.

A submission by Coles Myer in 2005 stated that the company imported around three per cent of their total fruit and vegetable requirements from overseas.

A 2005 ABARE survey considered that the percentage of imported fresh fruit and vegetables to be around 1 per cent, although the basket of goods chosen was selective.

Imports represent 2.56 per cent of the total value of farm gate production if we use the value of imports and gross value of production as rough measures. Note comparing total farm gate value will provide percentages greater than if we compared retail value. The difference could be as high as 70-120 per cent depending on the line.

Given the above information HAL concludes that imports form around 3-4 per cent of industry value in today's terms.

10.2.2 GOVERNMENT POSITION

The Australian government has confirmed that it will continue to pursue the removal of trade barriers, particularly so in relation to produce. The exception to this is where Australia may have issues based on quarantine matters. To this end Australia currently has in excess of 50 applications in front of Bio-Security Australia seeking to import a range of fruit and vegetables.

It appears that this trend will continue. For example, 1991 / 92 in New Zealand adopted an effectively 'open door' policy to a diverse range of fruit and vegetable products. At that time the value of consumption of produce was NZ$450-500 million. Ten years on and the value of consumption of produce has risen to NZ$1.1 billion, with nearly 50 per cent of that figure being imported produce (personal communication, Australian / NZ exporter / importer).

Australian Retailers as well as importers are expected to continue to foster this trend in at least the short term.

It should be noted however that due to the relative small size of the Australian market (approximately 20 million people) some produce lines may not be economical to import according to some importers.

10.2.3 PRODUCT OF ORIGIN

One of the central concerns frequently raised by Australian fruit and vegetable Processors is that the guidelines associated with the Trade Practices Act regarding a product's origin are not specific enough to guarantee consumers that they are in fact buying Australian produced and packaged product, if that is what they are seeking to do.

For fresh produce the laws were made clearer on the 8th June, 2006 when Food Standards Australia & New Zealand gazetted the Country of Origin Standards Food Labelling Standards for Australia. All Retailers of fresh produce are required to indicate to consumers if the product is not produced in Australia or if of mixed origin the requirement is that it be labelled of "From Local and Imported".

Industry sources suggest that both MSC are complying with this direction in its entirety although the level of compliance amongst other Retailers is variable, in part occasionally due to a lack of knowledge by the vendor of the source of the product.

HAL's observations conclude that the consumer preference is for Australian products wherever possible. This is evidenced by the fact that many Retailers label their products as a matter of course as being 'Product of Australia" or similar. That said, it is also apparently rare that a fresh food Retailer will stock two product ranges, one Australian, one imported of the same variety. This is in part due to the aforementioned belief that in the majority of instances the imported product is available in Australia at time when the Australian product is not or in limited quantities.

10.3Quality Assurance Standards

HAL and the production sector have in the past expressed concern that the importation of some fruit and vegetables currently permitted into Australia may present a risk to either human health or bio-security.

In the report entitled "Ensure Equivalence of Imported Product", 2007, prepared by Food Compliance Australia Pty Ltd on behalf of HAL, the report concluded

> "*it is likely that current administrative processes set up in the Imported Food Inspection Scheme do assure the Australian community that all food imported into Australia complies with all requirements of the Code"….."In principle, domestic producers must comply with all the requirements of food as set out in the Code".*

HAL wishes to seek assistance from all parties that are involved in the importation of fruit and vegetables into Australia that they seek to ensure that the processes applied to evaluation of the product in terms of the Code are complied with and where necessary lobby government to ensure equivalence of the standards described in the Code between imported and domestically produced fruit and vegetables.

11. Codes of Conduct

11.1 Produce and Grocery Industry Code of Conduct

The voluntary Produce and Grocery Industry Code of Conduct (PGIC) has attracted much public debate over recent years. Industry organisations and those that act in an advocacy role for horticultural Growers have stated clearly their belief that this code has not been effective in meeting its stated objectives, the core concerns being:

- GPIC has not delivered improvements in the level of transparency for suppliers, and specifically horticultural Growers.
- Poor awareness of the GPIC amongst horticultural Growers.
- GPIC lacks teeth to protect the commercial interests of Growers who have limited market power compared to other parties to transactions, and provides no protection from commercial retaliation aimed at those with lesser market power, Growers.
- As a result of the above, the number of complaints lodged is not a valid measure of success of the code, as concerns of commercial retaliation and constraints to efficient disposal of farm produce inhibits the lodgement of complaints, rather unchanged practices of many parties with market power in the grocery (and specifically horticulture) chain is.

The introduction of the mandatory Horticulture Code of Practice is nominated by the horticulture industry bodies and advocates as clear evidence that the GPIC has failed in its objectives, specifically in relation to behaviour of the value chain for fresh produce supplied to the retail sector.

The perspective presented by the advocates for Growers may well be valid for a large number of smaller horticultural Growers in a holistic sense, however it must also be noted that the new mandatory Horticulture Code of Practice (HCOP) does not include Retailers. Further, some if not all advocates do not advocate for the HCOP to include Retailers in the future. The reasons for this position are summarily quoted as “there is no issue with Retailers acting as merchants in dealings direct with Growers”.

This view that direct commercial dealings between Retailers and Growers are efficient and resulting in satisfaction for the Grower suppliers, is supported by feedback from Grower Consolidators (larger Growers, who act as Grower Consolidators and are predominantly seen as preferred suppliers by Retailers, in their respective categories). Grower Consolidators indicate that the shortness of the chain when dealing direct with Retailers, the directness of communications between them and the Retailers, the sharing of information about projected volumes and category issues and trends and the ability to negotiate prices directly and in a timely fashion, results in high levels of satisfaction in their direct commercial relationships with Retailers, in particular MSC.

Growers that now act as Grower Consolidators and deal direct with MSC and other Retailers are predominantly amongst the largest and most commercially experienced Growers. These Grower Consolidators have stronger market power (albeit through one or more of scale, awareness, experience and commercial skills) than the great majority of fruit and vegetable Growers by number.

The position taken by Grower advocacy organisations and the feedback from Growers / Grower Consolidators dealing direct with Retailers indicates the GPIC is effective in respect to direct commercial dealings between these larger and more experienced Growers and Retailers.

11.2 Mandatory Horticulture Code of Conduct

Following an exhaustive process of debate and submission covering several years a mandatory Horticultural Code of Conduct was executed on December 13th 2006 and became operational in early 2007. The Trade Practices (Horticulture Code of Conduct) Regulations 2006 (HPOC) very specifically applies to traders (agents and merchants) and Growers selling their produce to an agent or merchant. This code does not and is not anticipated to, apply to Retailers when they do business directly with Growers or Grower Consolidators, as defined in this submission.

In relation to the HCOP, industry oganisations and Grower advocates acknowledge that there are many examples where the introduction and compliance with the code has resulted in successful business relationships between Growers and traders as defined by the code. However there is a substantial groundswell of dissatisfaction being expressed by these bodies about the level of non-compliance from traders, the tactics utilised by many traders to avoid complying with the code, and the will and ability of the ACCC to enforce the code and understand the commercial dynamics between these two traditionally disparate thinking groups.

The continuing issuance of non-compliant Horticultural Produce Agreements (HPAS) by traders, intimidation bordering on stand-over tactics, failure to sign and thus execute compliant HPAs once signed by Growers and other measures are all cited as common amongst those traders who are not willing to change their business model to comply with the HCOP. Advocates are also critical of the ACCC for lack of enforcement of the code and an apparent lack of will to understand the real dynamics of relationships between traders and Individual Growers. Core to this dynamic is the very real difference between the commercial exposure, experience, acumen, scale and thus market power, between traders and many Growers.

On one hand the trader population has many years of very direct transactional experience with large and small businesses that equips them particularly well to negotiate and communicate with Growers from a position of strength. On the other hand a large proportion of Growers by number are very small businesses that have been passed down through generations of farming families, exist long distances (physical and cultural) from today's aggressive commerce and whose managers and operators have not been trained in commerce or general business practices, rather having a strong skill set in technical and practical production matters.

Amongst traders whom have implemented HCOP a common view is that it has not had any detrimental impact on their businesses and relationships between themselves and their Grower suppliers have only been supported by the introduction of the code. Those traders not supportive of the code are unfortunately harder to gather clear and genuine perspectives from.

The commonly held view amongst horticultural industry participants and their representative organisations and advocates is that the code is not achieving its nominated goals of addressing the imbalance of power in the Mid-Chain in its current form and with the current level of enforcement and oversight coming from the ACCC.

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