

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

March 2008

The Australian Chamber of Fruit & Vegetable Industries represents the vast majority of the fresh produce wholesalers operating in Australia's six central markets.

We provide service and advice to our members on matters that may have an affect on the operation of their businesses now and in the future.

Rather than provide answers to the many questions put forward in the issues paper, we have decided to give an overview of the central market system and then to provide comment on the Horticulture Code of Conduct.

Overview of the Fresh Produce Wholesaling Sector and the Central Markets

Competition within the central markets is fierce. There is no other sector of any other industry in Australia where businesses operate next door to each other in direct competition for their neighbour's suppliers and customers.

If a wholesaler does not look after their suppliers they will lose them to a competing wholesaler. If a wholesaler does not look after the needs of their customers, they will lose them to a competitor who can satisfy the customer's requirements.

The central markets receive produce from large and small growers from all regions of the country and sell produce to all types of buyers, large and small, from all regions of the country. The markets are a source of supply for all retailers, processors, exporters, providors, caterers and restaurants to name a few. Each of these buyers has a different requirement as to quantity, quality, size and range of produce types. The markets are unique in that they can meet all of these differing needs.

The markets are driven by three influences ie. supply, demand and competition. Demand from the various buyers that use the central markets for their needs creates the competition between the wholesalers to provide the product that the buyers require. This in turn creates the demand from the wholesalers to their suppliers to provide the required product in the quantities demanded. These functions of supply and demand will establish the range of prices for a particular product line and the quality supplied will determine where a particular suppliers produce sits within that range of prices.

As a general rule the domestic fruit and vegetable market is oversupplied which creates a situation where the overall price to consumers is kept to a reasonable level. Prices may increase on selected lines due to climate and other factors that affect supply but if one product is in short supply there is usually an alternative product that is in oversupply. Australian consumers are fortunate to have a choice of product at reasonable prices available all year round.

The central markets of Australia are the main reason why this choice and value is available to the consumer.

Suppliers

The wholesalers in the central markets provide an outlet for growers to sell their entire crop not just the sizes and quality that is selected by the Major Supermarket Chains (MSC's). Those growers who supply the MSC's also send the produce to the markets.

They have a choice of wholesaling businesses with which to trade, the wholesalers are able to market large volumes of their produce to MSC's and the larger independent retailers while also being able to find niche markets for the more unusual produce lines.

The vast majority of growers supplying the markets have strong, long-term ties with the wholesalers that they do business with. Some of these relationships span generations of the same families and in some cases result in strong personal friendships as well.

The Good Growers

Growers who are reliable suppliers of consistent quality produce will find that they are in great demand and enjoy good returns for their produce. This is because the wholesaler is assured of the supply and will know the level of quality of the produce. Therefore he will often be able to tell his customers of its imminent arrival and create demand for the produce. This will result in a quick sale and good returns for both grower and wholesaler.

These types of grower are highly valued and a wholesaler will do all he is able to ensure that the grower continues to supply to the exclusion of other wholesalers.

The Not-So-Good Growers

However, growers that supply erratic quantities of inconsistent quality produce and change from wholesaler to wholesaler are in less demand as suppliers.

These growers will supply produce unannounced or supply volumes below or above the levels indicated to the wholesaler. If the grower undersupplies, the wholesaler will disappoint his customers by not being able to supply their requirements as promised. If the grower oversupplies or supplies product without notification then the wholesaler is left with product that has to be cleared resulting in the grower being paid less than otherwise achievable.

Similarly with inconsistent quality of product, the wholesaler never knows what to expect when the product arrives. He cannot promote it prior to arrival because the quality may not meet the expectations of his customers. These growers are also noted for "topping" the produce containers ie. the top layer may be high quality but the lower layers are of a lesser quality.

This creates problems because the wholesaler's customer will complain or return the produce and will stop buying from the wholesaler if it occurs too frequently. The customer will certainly not wish to purchase that grower's produce again which in turn means that the wholesaler has one less outlet for that grower's produce. The wholesaler also runs the risk of losing a good customer because of the practices of one erratic grower.

The wholesaler will tolerate this type of action for a while but if the grower's practices do not change he will tell the grower to take his business elsewhere. The grower will go to another wholesaler, then another until the grower discovers that he has a reputation as a poor supplier resulting in diminished outlets for his produce.

Grower/Traders

The Sydney, Melbourne and Adelaide markets make provision for growers to sell their own produce, and other growers' produce, from the market floor.

In Sydney there is approximately 400 growers who trade in this manner, Melbourne has a similar number and less in Adelaide. These grower/traders will sell to all the different buyers in the market, including the general public in Sydney, but less so to the MSC's.

They will take orders from their buyers and if they do not have the particular lines that the buyer requires they will purchase from other grower/traders or from the wholesalers.

The prices paid by the buyers to the grower/traders will reflect the current market price for that product.

The Major Supermarket Chains (MSC)

While the MSC's may be sourcing produce direct from growers, packers or other marketers they still source a considerable amount of produce from wholesalers in the market.

While difficult to define, it is estimated that the two MSC's handle approximately 60% of all fresh produce sold in Australia. It is also estimated that approximately 50% of that produce is sourced direct from suppliers other than the wholesalers in the markets. Therefore the assumption is that approximately 30% of market sales is to the MSC's.

This percentage may vary depending upon the product being sourced and climatic conditions that prevail at the time. For instance, if the lines being sourced are not major turnover lines the MSC may source these products through a few selected wholesalers rather than trying to deal with many direct suppliers of small quantities.

Also too, if there is a natural condition that destroys or diminishes the crop being grown by a direct supplier, the MSC may turn to the market to make up any shortfall that they may have in their requirements.

When buying from the markets the MSC's will pay a price that reflects the current market price for that product. They may negotiate with the wholesaler depending on quantities required or other factors that may influence the price but the wholesaler cannot negotiate a price that would make the return to their supplier a price that is well below the established market price. If they were to do so then the wholesaler would run the risk of losing that supplier.

The MSC's will use the prices set by the central markets to establish the prices that they will pay to their direct suppliers.

The Independent Retailers

Independent retailers are current enjoying a resurgence in their businesses. It is quite common for these independents to establish their stores in close proximity to the MSC's. They then attract business from the MSC's by offering a more personalised, expert service and a quality that the MSC's find more difficult to provide.

The consumer also enjoys the competition that the independents provide and will often do their grocery shopping at the MSC's and then go to the independents for their fruit & vegetable purchases.

The independents can be small single shops or may be large operations with stores in many locations. The independents generally use the central markets as their source of supply.

Like the MSC's, the independents will pay prices that reflect the current market price for that product. Again the volume of the purchase may be taken into consideration when the wholesalers are negotiating the transaction.

The central markets support the activities of the independent retailers as they provide competition for the MSC's both in the market and to the consumer. If the independents were not as strong as they currently are, the MSC's would have a greater control of the produce market.

Providors, Food Service and others

This group of buyers uses the markets to source all product they require and is an increasingly significant sector in the food industry. They require smaller quantities of a vast range of produce types and it is not possible for these buyers to source the product directly from growers. The central markets are the only viable source of product for these buyers.

This group will pay the current market price for the produce they require.

Conclusion

The central markets and the wholesalers operating within those markets provide a source of product for the whole food industry, not just the MSC's. While the central markets retain this position they provide the catalyst for competition for all retail and service sectors.

This in turn enables the likes of the independent retailers to compete effectively with the MSC's thus containing the cost of fresh fruit and vegetable to the Australian consumer.

If the central markets, or the traders therein, are constrained or made uncompetitive with the MSC's then the consumer will be the one to suffer higher prices for the fresh produce that is so important for the health and wellbeing of the general population.

Comments on the Horticulture Code of Conduct (Questions 81-83)

Background

The Horticulture Code of Conduct was the result of a political decision made by the previous Coalition Government. The accuracy of this statement will be borne out in 28 years when the Cabinet papers are made public.

It came about as the result of pressure placed on the then government, just prior to the 2004 election, to introduce regulation or face a concerted campaign by code proponent organisations and individuals to vote against the Coalition at the upcoming election.

The decision was also made despite the findings of the CIE which was contracted by the Government to provide a Regulatory Impact Statement on the introduction of such a code.

Legal Aspects

There is also serious doubt as to whether the government was legally able to introduce such regulation under the Trade Practices Act 1974. While the Act allows for the government to impose a mandatory code of conduct on an industry, this particular code is only imposed on part of an industry.

If the Horticulture Code of Conduct was true to its name, it should apply to any entity operating within the horticulture industry. However, retailers, processors and exporters, which are all major participants within the horticulture industry, are specifically exempt from having to abide by this code.

Additionally, many horticulture producers, and some wholesalers, are family partnerships, sole traders or other entities that are not subject to the Trade Practices Act and thereby exempt from complying with any requirement under this Code.

Unless of course, these unincorporated entities were to trade across a State border, in which case they would be subject to the Code. For this reason the Code appears to fly in the face of the Mutual Recognition Act 1992 which was designed to remove barriers to trade between the States.

At the very least this Code should not be called the Horticulture Code of Conduct as it does not apply to the Horticulture industry. No suggestion is offered as to what it should be named but it is certainly not an industry code.

The fact that nursery operators and turf suppliers are also counted as part of the horticulture industry will not be expanded upon in this submission.

Some outcomes of the application of the code

Due to the applications and exemptions under this regulation there is no longer a level playing field operating in the horticulture marketing sector.

The regulatory and compliance burden is borne mainly by the wholesale sector of the industry and it is this sector that provides the capacity for the independent retailers and others to compete effectively with the MSC's.

By constraining the wholesaling sector with the Code and burdening it with increased cost, while leaving others to trade as the parties agree, competition has been lessened and will ultimately result in increased prices to the consumer.

Another interesting outcome of the imposition of this regulation is that it makes trading in imported produce more attractive because the regulation does not apply to this trade either.

Impact of the Code on Market behaviour (Question 81)

The Horticulture Code has had an impact in ways that were not anticipated by the proponent and authors of the Code.

Those growers who have not bothered with transparency in the past still do not seek any improvement. The most obvious of these is the refusal of many growers to sign agreements but still continue to send produce.

The way that the code is written means that a grower, who refuses to sign an agreement, can never be in breach of the code until a wholesaler purchases the produce, and then both will be in breach.

A grower can send produce unannounced, without signing an agreement and the first time a breach of the code occurs is when the wholesaler touches the produce.

A wholesaler will also be in breach if he deals in the produce without the grower signing an agreed price form and returning it to the wholesaler. Given that the product is highly perishable, and the reluctance of growers to sign any document, the wholesaler is placed in a predicament that is very unpalletable.

The reality is that a lot of the business continues to be conducted on agreements entered into prior to the implementation of the code. Any growers and traders that have had a long term relationship have pre-existing agreements in place and those agreements are not subject to the code.

One distinct result on behaviour in the marketplace is the reluctance of wholesalers to accept produce from new growers that wish to supply them. As most of the established growers and wholesalers are operating on pre-existing agreements a new supplier usually means increased paperwork, cost and a possibility of prosecution if a mistake is made in any of the requirements under the code.

This means that the opportunity for growers to change to another wholesaler has been diminished. Unless the grower is substantial or able to provide a unique or vastly superior product most wholesalers will not take the risk of operating with new growers under the code.

Where existing growers have opted to trade under the code after its introduction, wholesalers are now assessing whether these growers are worth the extra time, cost and risk of prosecution in continuing to deal in their produce.

Impact of including the retailers under the Code (Question 82)

The code is so poorly drafted and its application and execution was flawed from the outset, to even consider including others under this code would be a complete injustice to those that would be caught up under this regulation.

Whilst it may solve some of the legal issues discussed previously and seek to address the current market imbalance, it certainly would not add any value to the industry. In fact the effect would be that the entire industry would suffer.

However, if the intention is to retain this regulation in its current form it may be the only opportunity to again level the playing field. However, the question would have to asked "at what cost?"

Improving the effectiveness of the Code (Question 83)

The inclusion of the rest of the industry under this code would not improve the effectiveness of the code in the slightest. It would impose the same costs on those that are currently excluded but it would not improve the code's effectiveness.

In conclusion on the code

This code was deceptive in its inception, flawed in its design and is discriminatory in its nature. It was not introduced because there was a demonstrated need for such regulation, it was introduced in an attempt to win votes prior to an election.

It also has serious legal question marks surrounding its existence and application.

Until these issues are resolved what is to be gained by further extending this flawed regulation?

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