



George Weston Foods Limited

Submission to ACCC Grocery Inquiry

17 March 2008

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1. George Weston Foods Limited

GWF is a wholly owned subsidiary of Associated British Foods plc, one of the world's leading food companies. GWF is one of the largest food manufacturers in Australia, supplying grocery wholesalers and retailers with a range of food products which are manufactured by its baking, meat & dairy and milling operating divisions. These products include breads (Tip Top®, Burgen®, Noble Rise®, Bazaar Breads of the World), crispbreads (Ryvita®), bakery products (Golden®), cakes (Top Taste®), flour and bread mixes (Tip Top®, Kitchen Collection®) and processed meats (Watsonia®, Chapmans®, Huttons®, Melosi® and Don®). GWF also produces some of these products under generic (non proprietary) labels under contract for retailers. Further information about GWF and its product range is available at www.georgewestonfoods.com.au.

2. The Inquiry

George Weston Foods Limited (**GWF**) welcomes the opportunity to respond to the matters raised in the Commission's Grocery Inquiry (*the Inquiry*).

The Inquiry covers pricing issues which were the subject of earlier Commission inquiries. GWF's response in respect of the Commission's 2002 Report to the Senate on the prices paid to suppliers by retailers in the Australian grocery industry remains relevant.

GWF operating businesses manufacture and distribute a range of products relevant to the Inquiry from 38 manufacturing sites around Australia and New Zealand. The complex nature of GWF's businesses means there are different operational models used in different GWF operations. In particular, each of GWF's operating businesses is responsible for negotiating prices, trading terms and promotional support with each customer. Requirements are driven largely by negotiations with GWF's major customers - Coles, Woolworths, Aldi, Metcash and food service providers. Accordingly, the answers to the matters raised in the Commission's Issues Paper are complex and not consistent between GWF businesses. We have therefore provided general information in response to these issues, and referred to particular businesses or products where appropriate.

On 5 March 2008 GWF received an information request from the Commission in respect of GWF's bread products. GWF's response to this request will be provided separately.

3. Confidential Information

This submission is provided on the understanding that it is to be used for the limited purpose of preparing of the Commission's response to the Minister.

While GWF has sought to provide general information of the type requested, the Commission will appreciate details of prices, trading terms and promotional/assistance programmes are matters of the highest commercial confidence and are subject to strict confidentiality restrictions.



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4. Changes in the industry

There have been significant changes to the structure of the grocery industry over the last five to ten years. These have included, but are not limited to:

- the programme of structured acquisitions by the major supermarket chains (**MSCs**), accompanied by a shift to a predominantly national structure;
- the exit of Dairy Farmers from the retail grocery sector, with the sale of a significant number of Franklins supermarkets to Woolworths and independent operators;
- an increasing reliance on price and lower price promotions as the point of competitive differentiation among retailers;
- MSCs entering petrol retailing and the establishment of associated "shopper docket" loyalty rewards schemes;
- the entry of ALDI into the retail sector as a low cost, integrated discount retailer selling a limited range of everyday products at significantly lower prices, which has increased the pressure on prices for all of these products and provided an alternative source of basic grocery products for consumers;
- the continuing development and expansion of retailer 'house brands' to compete directly with branded (proprietary) products and the associated decline in retail shelf space available for brands; and
- changing shopping patterns that require the delivery of product to more flexible and frequent timetables.

5. Response to Issues Paper

GWF provides the following answers in relation to specific questions raised by the Commission. For convenience we have adopted the Commission's numbering.

Q 1 What have been the major causes of rising food prices in Australia?

There are a number of factors which have contributed to rising food prices including increasing prices for ingredients (especially wheat), labour and energy costs.

Many of GWF's products are heavily grain dependent – not only do we use grain to manufacture our flour, bread, cakes, crispbreads and bakery products, we also purchase stock feed. Accordingly, any conditions that have the consequence of increasing grain prices can significantly impact on GWF's production costs. Other relevant but smaller inputs include oil, eggs and dairy products.

The cost of inputs is determined by worldwide commodity markets but is also affected by domestic conditions. Recently, both global and local factors have contributed to rising prices. While commodity prices have risen worldwide, Australia's sustained drought is having a



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significant impact on producers in all sectors. In the specific cases of pig producers and manufacturers of baked goods, the immediate effect has been a significant and continuing increase in already high grain costs as they compete for increasingly scarce resources with other producers such as stock feed manufacturers.

While drought conditions are a significant factor locally, producers worldwide are also facing increased grain costs due to shortages caused by growing demand for ethanol, strong economic growth in China and India and a rapid increase in the number of feed-lot cattle in Japan. The effect of the drought has also been compounded by escalation in fuel prices which affect distribution costs. This is particularly acute in Australia where goods are often transported considerable distances.

Q 17 The steps in the supply chain from supplier to retailer

The steps in the supply chain from supplier to retailer vary between product categories but can broadly be described as follows:

- An order is placed;
- The order is processed through the electronic data interface and electronic order transfer systems. Depending on the customer this process might include also order acknowledgement, stock confirmation, advanced shipment notices, reverse invoicing.
- The requested product is manufactured or sourced from already manufactured supplies;
- The product is picked and packed; and
- The product is delivered. For primary freight customers, the order is delivered direct to the customer (retail store or warehouse) or collected from the factory gate by the customer. For non-primary freight customers, a contract freight carrier delivers to the customer's warehouse or distribution centre.

For GWF's bread products the supply chain contains a number of additional elements. In that case, drivers sort and deliver bread direct to the store, provide merchandising services in some cases and may also collect returns.

Q 18 The activity or value added at each step

The activity or value added at each step will vary depending on the product being processed but can include: store-ready packaging, palletisation, loading, refrigerated transport, logistics planning, vendor managed inventory (we replenish a customer's warehouse via our employee working within that customer's site), packing display shelves and replenishment in stores, returns (where a retailer only pays for stock sold) and merchandising.

Q19 The businesses or business types that undertake each activity

Each GWF business has different supply arrangements and these vary again according to product:



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- For GWF's Baking Division, the supply chain process is governed by use by date. For products that have a short use by date, such as fresh bakery products, GWF performs each step in the supply chain; delivering product direct to retailers on a daily basis across Australia. Those products that have longer use by dates such as flour in retail packs, crispbread and cakes are delivered to the warehouses of the MSCs and directly to independents and the route trade.
- GWF's ham, bacon and smallgoods products are manufactured at GWF's manufacturing plants and, in the case of some specialised products, on a contract basis by other manufacturers. GWF obtains kill and boning services under contract in Western Australia, South Australia and Victoria. Don, GWF's meat division, also outsources the distribution element of the supply chain with products for route and food service customers going to a warehouse and organised retail going straight to a distribution centre.
- Cereform supplies ingredients and frozen cakes to Woolworths' in-store bakeries. It controls all aspects of the supply chain except the distribution of ingredients which are picked up and distributed by Woolworths.

Q 20 The pricing structure in each step.

The cost per unit of each element of the supply chain depends on product and brand in question, varies widely and is made up of a combination of cost inputs, product design and business margins.

Q 21 The proportion of the final retail price of the product accounted for by each part of the supply chain.

Retailers are responsible for setting end prices.

Q 23 Would unit pricing improve the ability for customers to compare prices? Should unit pricing be made compulsory? Would unit pricing lower the cost of shopping for customers?

Unit pricing provides more information to consumers and would improve the ability for consumers to compare prices. It may allow consumers to lower the cost of their shopping.

GWF is of the view that unit pricing would not necessarily shift the shopping habits of most consumers as price is but one of a myriad of factors that consumers take into account when making purchases. While unit pricing may provide a point of differentiation and competitive advantage for retailers, GWF supports minimum effective regulation and does not consider that unit pricing should be mandatory especially since providing this information would involve a cost likely to be borne by suppliers.



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

Customers require tailored approaches depending on their operational modes or business strategy, which may result in differing proportions of overall support. Accordingly, there are no standard trading terms between the different GWF businesses and their customers.

Trading terms have many components which derive from considerations of volume, efficiency, business growth and strategy. Some components are fixed values, others are variable sums designed to stimulate demand and sales. Trading terms may also differ depending on the particular products within the overall product range that are supplied to a particular customer. Additionally, with some of our major customers, the negotiation of prices, trading terms and promotional assistance occurs on a State by State basis rather than at a single national basis.

With some customers, some of GWF's operating businesses have moved to a business development plan approach rather than the traditional trading terms approach. Again, there is no uniform position across the businesses and a particular customer may have a business development plan in place with one operating businesses but may still be operating on trading terms with another operating business.

Some GWF operational businesses issue comprehensive wholesaler price lists. There is variation from State to State and also, at times, from metropolitan and country areas. The wholesale price lists are otherwise the same for all customers and any list price reduction is available to all customers. Any difference is derived from the trading terms, business plan discounts and/or specific promotional deals which have been negotiated and agreed with the customer.

Broadly, MSCs offer suppliers national scale, reach and access to critical shelf space that smaller retailers cannot provide. This scale allows MSCs to drive larger volumes, influence and run promotional programmes independently and ultimately reduces the end price they are able to source product for. MSCs also have a national distribution network which allows suppliers to take advantage of the efficiencies associated with this.

The ability to deliver on the execution of promotional programmes is a critical issue for GWF. Trading terms are therefore likely to reflect, amongst other things (eg locations, shelf space, ranging, volumes, number of delivery points) the level of support GWF receives from particular customers.

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

In GWF's experience, discounts are often passed on by retailers but this is not constant across all product lines. In the case of bread, GWF's experience is that lower prices available by way of discounts or promotional deals are consistently passed onto consumers by all retailers. That said, retailer discounts may not directly coincide with supplier price reductions and occasionally a retailer will sell below the price discount we are able to offer and



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sometimes slightly above. Accordingly, when seen across a timeframe of a few months, discounts are passed on to consumers. In fact, since such discounts are provided to drive volume, if they were not reflected in retailer pricing GWF would be reluctant to continue providing them.

Q 48 Do suppliers incur lower unit costs in supplying larger wholesalers or retailers? What are the sources of these costs savings (bulk sales, purchase guarantees?) Are these reflected at a retail level?

Broadly, yes, see our response to question 46 above. These cost efficiencies are related to the volume of product purchased and delivered. MSCs offer suppliers national scale, reach and access to critical shelf space that smaller retailers cannot provide. This scale allows MSCs to drive larger volumes, influence and run promotional programmes independently and ultimately reduces the end price they are able to source product for. MSCs also have a national distribution network which allows suppliers to take advantage of the efficiencies associated with this. Obviously, the nature of some products, including bread means we are not able to capitalise on these efficiencies.

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

While volume is an important consideration, the volume of purchases does not in and of itself determine whether customers are 'like customers'. What is at issue, and suppliers are paying for, is the level of support that the retailer provides to the supplier. This varies dramatically from customer to customer and is not solely dependant on volume. Bread, for example, is supplied direct to store based on a price list. The price list does not relate to quantity purchased and there are no further discounts for bulk purchases in the trading terms for bread products. The price to the customer is the same whether they purchase five or five hundred loaves. Because GWF operates on a full sale and return basis for bread, it is not in our interests to ask retailer to order high volumes when these will just be returned.

Particularly when dealing with Banner Groups, the level of support provided to GWF can vary dramatically from store to store even though the promotion has been negotiated on a group-wide basis. It is often the case that with such customers we have to spend significantly greater time just trying to ensure that the agreed promotions are being properly executed. Obviously this adds to our costs and will ultimately be reflected in the price (or terms) with the customer.

By comparison, in promotions runs by the MSCs, they largely deliver on the execution, with GWF staff merely assisting. The ability to deliver on the execution of promotional programmes is a critical issue for GWF. Trading terms are therefore likely to reflect, amongst other things (eg locations, shelf space, ranging, volumes, number of delivery points) the level of support we receive from particular customers.



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This issue was discussed extensively in the Commission's 2001 report to the Senate.

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

The strong countervailing power of the MSCs is well documented. In the context of the smallgoods industry, the IBISWorld Risk Report noted¹:

One of the biggest threats facing the profitability of the industry is the ongoing consolidation of the industry's retail foods client base. The continuing reduction in the number of retail buyers, the growth of giant supermarket chains and the use of category management practices is weakening the negotiating strength of the industry's players in supply contracts. The uptake of global supply strategies by the large supermarkets has also been one of the most significant issues facing the Australian Bacon, Ham and Smallgoods manufacturers.

The ability of the MSCs to provide a fledgling brand with national coverage via a listing following a range review is an enormous strength. Obtaining this coverage is crucial to the launch of a new product.

The effect of this countervailing power extends beyond direct dealings with the supermarket chains, and for some products but not bread which has a single price list, acts as a constraint on pricing to smaller supermarkets, delicatessens and route trade outlets. While pricing to these outlets may be above the wholesale prices negotiated with the supermarket chains, the lower retail prices at large supermarkets restrict the retail price which can be charged by these retailers. While most customers are prepared to pay a premium for service and convenience at these outlets, there is a limit to the amount above large supermarket prices which can be charged, and pricing above this level will result in loss of customers. This means that the prices negotiated by suppliers to the MSCs indirectly constrain the prices which those or other suppliers can charge to smaller retail outlets.

Q 51 Do slotting fees reflect the existence of market power? What is the extent of slotting fees? How do slotting fees affect the competitive dynamic between producers / suppliers and the level of barriers to entry? How does the ability of supermarkets to control shelf placements and in-store promotional offers affect the competitive dynamic?

Slotting fees reflect the competitive importance of particular in-store locations and are generally higher for new products. They are not payable on all products and may not be distinct fees but incorporated into trading terms.

MSCs and independent retailers actively manage shelf placement and promotional offers and tend to support the best performing lines which may adversely affect smaller suppliers. The 'shelf squeeze' has become more acute recently as retailers have reduced the number of

¹ IBISWorld Industry Risk Rating Report, Bacon, Ham and Smallgood Manufacturing in Australia, 1 September 2007, page 10



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products or product variants in particular categories in order to minimise supply chain costs and accommodate new and private label products.

Promotions are individually negotiated with each customer. The level of support provided by GWF will depend on a variety of factors but revolve around what the customer is seeking to do, how much GWF is prepared to fund them and how much the retailer is prepared to contribute to the promotion. The retail selling price is of course always the decision of the customer.

Q 53 How could grocery wholesalers or retailers exercise any market power? Could major retailers credibly threaten to 'delist' a product or brand? How would consumers react if their desired brands are not available at their local supermarket? How important is the potential for a grocery retailer to substitute a private label or generic product? 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? What are the consequences at the retail level?

The use of category management practices is adding to the negotiation power of the major retailers in supply contracts. The MSCs conduct range reviews twice a year. If a product is delisted as a result of the range review process it can affect its ability to survive.

For all of GWF's products, the threat of delisting is certainly credible. Any such threat has to be weighed against the requirement for retailers to provide a comprehensive range which includes consumer preferred brands. While for a percentage of consumers private label products are a relevant choice, a more limited range may have the effect of driving consumers elsewhere.

The rise of 'private labels' over the past five years is well established, and retailers are using private labels to keep pressure on branded products and keep the prices that they acquire at down. The growth of private labels in some product categories is over 40%. In some categories this growth is fuelled by the delisting process pursuant to which many enduring national brands are disappearing and suppliers are not being given the opportunity to replace failing brands or SKUs with new products.

The uptake of global supply strategies by the MSCs has been one of the most significant issues facing suppliers. Whether a retailer is in a position to threaten import of products in preference to local brands largely depends on the product in question. Bread, for example, because of its short shelf life is not subject to these sorts of threats. Similarly, despite relaxation of historical quarantine restrictions, the quantities of imported smallgoods products are still very small.² Generally, however, retailers are able to and do source products worldwide.

If MSCs do seek to import product, suppliers will seek to place their products in alternative channels (including the export market). Obviously the channels that are viable will depend on

² Imported smallgoods are estimated by IBISWorld to comprise only 0.5% of the total domestic sales of ham, bacon and smallgoods. See page 13 of IBISWorld Industry Report, Bacon, Ham and Smallgoods Manufacturing in Australia C2113, 25 May 2007.



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the product in question. For example, in addition to the MSCs, GWF already supplies customers in food service, convenience, route trade, fast food and catering and exports some fresh pork meat, mainly to Singapore, with a small volume exported to New Zealand and exporting flour and frozen baked goods to the Asian region.

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

Our prices are based on manufactured cost plus an appropriate margin. Manufactured costs are to a large extent determined by commodity and utility prices, both of which have increased significantly over the past few years. They are also influenced by inputs such as ingredients, packaging, warehousing and distribution costs as well as factors such as competitor activity and pricing and seeking to achieve the right 'value for money' pricing point based on a product's perceived quality versus the perceived acceptable consumer cost.

The proportion of the retail price that GWF receives depends on the retailer and the product in question. In bread, for example GWF receives approximately 75% of the retail price.

Q 67 Have the prices you receive for your produce changed over the past 1 to 3 years? What have been the major reasons for any change? Have your costs of production changed over the past one to three years? Have the prices you receive for your product changes by more or less than your cost of production?

While there is some variation, broadly the prices GWF receives for its products have slightly increased over the past one to three years. However, the costs GWF incurs, particularly for grain and fuel, have increased significantly while price increases have been kept to a minimum by competitive pressure across all product lines. Consequently, GWF's gross margin has declined over the past few years, as GWF has not been able to fully recover increases in its cost of production.

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

The distribution channels that are used by GWF depend on the product category.

GWF's Cereform business supplies Woolworths' in-store bakeries with frozen and ambient product. Other GWF bakery products including bread are sold to wholesalers, MSCs and independent supermarkets, route, convenience outlets, fast food outlets, food service distributors and caterers. GWF smallgoods are sold to many of the same channels including wholesalers, or direct to food service customers, quick service restaurants and food manufacturers and to retailers such as delicatessens, supermarkets and butchers for on-sale to consumers. Some products are sold in retail packs (or "pre-packs"), such as shaved meats or frankfurts, which are sold in the dairy-case at supermarkets, others are sold as individual



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items which may be purchased by end use consumers whole (such as ham or salami) or having been freshly sliced by retailers.

As set out in answer to question 53, the channels that are viable were the MSCs to be foreclosed will vary depending on the product in question. For example, GWF already exports some fresh pork meat, mainly to Singapore, with a small volume exported to New Zealand but export is not possible for fresh products such as bread.

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

If a MSC puts pressure on GWF to lower prices we are not in a position to ‘make this up’ elsewhere. As set out above, the specific terms of our arrangements with our customers vary. For example, GWF Baking operates a standard wholesale price list and any list price reduction is available for all customers. Temporary price reductions by way of promotional deals are negotiated with individual customers. Both MSCs and smaller route outlets receive various promotional deals built into the pricing structures GWF offers to retailers.

Q 73 Is there evidence of market power in the supply of grocery products to retailers or wholesalers?

No.

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

End pricing is solely at the discretion of the retailer and it is up to the retailer to pass any saving on. As noted above, cost savings reflected in GWF's wholesale price are sometimes but not always passed on by retailers to consumers.

Q 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 investments and innovation along the supply chain?)

An increasingly tough competitive environment makes it difficult to achieve acceptable margins and limits investment decisions.

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



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Any market power that a supplier has is significantly diminished by the countervailing power of the MSCs who effectively control the process. A supplier is not in a position to charge more or provide less as the consequences of such a challenge to the MSCs would be profoundly detrimental.

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

As set out in response to question 53 above, retailers have been aggressively driving their respective private labels. This strategy has been conducted in a structured way and has been particularly pronounced over the last year with private label products seen as a way of building customer loyalty and improving overall retailer margin. Where the growth of private has been fuelled by the delisting process it has been to the detriment of some brands, particularly in the lower tiers.

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

Arrangements with customers are flexible and negotiated. In regard to price increases, In GWF's experience retailers are prepared to review/negotiate, based on the prevailing circumstances. For example, customers understand that wholesale prices change to reflect changing input costs and market conditions such as drought and tend to be realistic and supportive where an increase is clearly correlated to rising costs.

That said, some arrangements are more restrictive and at least in the case of processed meat, Coles limit suppliers to a 5% increase. Above that increase, the contract is put out to tender. Pricing for the supply of meat for private label contracts is locked in, with no scope for change.

Where price savings are made, they are always accepted and at least in GWF Baking's experience, are passed on to consumers in the form of lower prices.

6. Further information or queries

We trust these comments are of assistance to the Commission. Please contact Tim Wong, Group General Counsel (029414 3830) if you require additional information or have any queries about this submission.

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