RETAIL GUILD OF AUSTRALIA

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AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

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ATTENTION: Amy Bellhouse and Mark Laybutt

Re: ACCC Inquiry into the Australian Dairy Industry

This submission is prepared by the Retail Guild of Australia Inc, who is the representative body for IGA supermarket retailers.

MILK in Independent Supermarkets

There are approximately 1,500 IGA supermarkets, 60% of which are IGA sized (400sqm - 1,200sqm in size) and 40% of which are Supa IGA sized (1,200sqm – 8,000sqm in size). IGA is predominately in the top up market whilst Supa IGA is focussed on the weekly shop. Milk is a key product in all IGA supermarkets. In IGA stores, milk comprises between 4% - 7% of sales, whilst total dairy sales comprise approximately 12% of sales. In SUPA IGA stores milk comprises approximately 3% of total sales, whilst total dairy sales comprise approximately 9% of sales.

Milk is a key item purchased by consumers throughout the week. Sales of milk are usually associated with the sale of other items as such milk is a key driver of business.

Milk is bought by independent supermarket retailers predominantly through contracts with the major processors. Those contracts are for the supply of at least 20 different dairy products, with milk to be sold in store at $1 per litre being one of those products. The wholesale price of milk for sale at $1 per litre is generally around 96c. The inclusion of $1 per litre milk in these contracts is made possible by the management of the overall gross margin across the total range of dairy products in the supply agreement with processors.

The cost of doing business in independent supermarkets is not less than 20%. Cost of business is the total cost of rent, electricity, wages and other fixed costs incurred in running the business. Milk sold at less than $1.17 per litre is being sold below cost because the wholesale price of milk is not less than 96c per litre. In practice what occurs is the loss on $1 per litre milk is apportioned across the entire dairy products range.

The marketing of milk below cost is misleading consumers into paying more for other dairy products.

Most independent retailers make milk available for sale at $1 per litre. The management of the volume of milk available for sale at $1 per litre is managed to ensure overall profit margins in the dairy category are maintained at a financially viable level for independent retailers.

The unintended consequence of $1 per litre milk is most consumers are paying more for dairy products (not including milk for sale at $1 per litre) to enable some consumers to buy milk at $1 per litre.

Impact of $1 per litre Milk in Service Stations

The Retail Guild believe the sale of milk at $1 per litre was commenced by Woolworths and Coles (the dominant chains) in an attempt to buy market share.

The sale of milk at $1 per litre is a marketing campaign first engaged in by Tesco in the UK in the early noughties. Milk as a key grocery item purchased by most consumers at least weekly is an item that draws customers for other purchases. Retailers who could not match milk sold at $1 per litre would ultimately lose customers.

In Australia, the $1 Milk marketing strategy was extended to dominant chain service station shops. This has had the effect of accelerating the decline of convenience stores across Australia, who on the whole did not sell milk at $1 per litre, because they couldn't remain financially viable to do so.

The Retail Guild is of the view that the $1 Milk marketing strategy by the dominant chains has worked because it has shifted market share. Consumers are now disadvantaged by the removal of competitors to dominant chain service station convenience stores. The removal of competition in the convenience/service station sector has enabled dominant chain service station stores to maintain exorbitant prices on the majority of products they sell.

Debasing Product Value

The sale of milk below cost is a debasement of that products value. In addition to gaining market share, the dominant chains use the debasement of a product's price, as a means to extract greater margin from suppliers across all product ranges.

The Coles agreement with Murray Goulburn started with a commercially healthy mix between $1 per litre milk and other dairy products. Over time as that agreement was renegotiated, the mix of products became financially unhealthy with a predominance of milk for sale at $1 per litre.

The debasing of the retail price of a product is only possible where a retailer has enough dominance in a market that it enable them to force suppliers to supply a product at a price which enables it to be sold below cost. This practice in the opinion of the Retail Guild is a misuse of market power which has had the effect of seriously damaging the businesses of milk producers whose businesses are focussed on the supply of fresh milk markets.

The Retail Guild believes the debasing of the retail price of milk will lead to less competition in the milk supply sector overtime.

The practice of debasing a products value by the dominant chains also sends suppliers a signal that they don't have any price control within any market for the supply any product. This practice enables the dominant chains to dictate wholesale price structures and terms, beyond the price and terms that would normally be possible in a conventional supplier/retailer relationship.

The practice of debasing the price of a product by the chains has also been used post $1 per litre milk in bread, hot chickens and meat lines.

The continued practice of debasing a single products retail value has not led to lower prices for consumers. The dominant chains in Australia currently operate on margins in excess of 4.8%, whilst comparable businesses in the Euro zone and the US operate on an average margin of 2%.

The Retail Guild believes the debasement of a products retail value is not leading to lower prices for consumers in Australia. Instead it is leading to greater market share for the dominant chains and greater power over suppliers by the dominant chains, which is enabling higher than average industry margins to be maintained.

Emerging Trends and Comments

The recent furore around Murray Goulburn's commercial relationship with dairy farmers has been the main driver of consumers increasingly buying branded milk which being sold in a range of between $1.55 - $2.30 per litre.

The facts reported in the press are that Murray Goulburn agreed to supply large volumes of milk for sale at $1 per litre to the dominant chains because at the beginning of this marketing practice, the mix of $1 per litre milk was low. However, over time the percentage of $1 per litre milk sales compared to all dairy product sales increased. Murray Goulburn's flawed strategy was the only option remaining, after they geared up to supply the dominant chains milk. When the world price for dairy products collapsed 2 years ago Murray Goulburn's risks were exposed. It was not the collapse of the world prices for milk products that caused this problem, it was $1 per litre milk.

Murray Goulburn's problems started with the sale of milk at $1 per litre. This is an example of misuse of market power in the supply chain by the dominant chains in Australia.

Ironically having started Murray Goulburn's problems, the dominant chains are now a beneficiary of them. Branded milk is not sold below cost. So a sale of branded milk in the place of milk sold at $1 per litre results in a significant margin gain for a retailer.

Interestingly, QLD IGA stores started a campaign to support branded milk when the dominant chains started the sale of milk at $1 per litre in 2011. It was only after the damage was done to Murray Goulburn that consumers started to support branded milk.

Dominant Retailer $1 per Litre Milk

The dominant chains give preference to the sale of $1 per litre milk, by placing it in prominent positions and ranging it to the exclusion of other milk brands.

The Retail Guild believes the dominant chains reported comments that $1 per litre milk comprises only 3.0% - 4.7% of total milk production is misleading in the extreme. The correct and relevant market for the purposes of this discussion is what percentage of "fresh milk" is sold in supermarkets to Australian consumers. That is because large volumes of milk production is exported or sold into the hospitality sector.

The Murray Goulburn problem stems from their inability to leverage viable margins from fresh milk sales arising out of the dominant chains ability to misuse their market power as outlined above.

In the retail sector, $1 per litre milk comprises a large portion of the fresh milk sector. The Retail Guild estimate that $1 per litre milk sales comprise at least 50% of all sales of fresh milk in the dominant chains. The Retail Guild bases this view on the fact that more than 50% of fresh milk shelf space in the dominant chain stores is devoted to $1 per litre milk. Any store view of a dominant chain store will confirm this fact.

Waterbed Effect flowing from $1 per litre Milk

The Retail Guild believes that supply agreements they enter into with processors for the supply of dairy product, are inflated to make up some of the margin not being made in the supply agreements processors enter into with the dominant chains.

The Retail Guild's view in this regard is informed by two facts. Firstly, the supply agreements with milk processors independent retailers enter, are at higher prices than those entered into by the dominant chains.

Secondly, for many retailers the actual supply of milk is made by milk processors in the same trucks that deliver to the dominant chain stores in their area. Which begs the question what is the difference in the cost to milk processors that justifies a different pricing structure as between independents and dominant supermarket retailers.

As part of this review, the Retail Guild recommends the ACCC undertake a detailed investigation of supply agreements with the dominant major supermarkets and independent supermarket sector.

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On behalf of the Retail Guild of Australia Inc