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UDV Submission – ACCC inquiry into the Australian Dairy Industry

UDV is the peak representative of dairy farmers in Victoria. We advocate on behalf of our members on issues arising in the dairy industry for the continued benefit and advancement of all Victorian dairy farmers.

As such, we are greatly invested in this current investigation into the Australian dairy industry.

The following is the submission by the UDV to the ACCC inquiry into the Australian dairy industry, in the hopes that it will strengthen the call to focus on various areas of investigation that have already been identified by the ACCC in their issues paper, but also to highlight a number of other areas that we believe should be examined.

As has been the case, we continue to offer any assistance that the ACCC should require in this and other related investigations.

Sincerely,

Adam Jenkins
President
United Dairyfarmers of Victoria

Executive Summary

United Dairyfarmers of Victoria (UDV) asks the ACCC to direct its investigation to specific concerns in this dairy inquiry:

- The use of milk swaps and intimidation tactics by large processors against other milk companies have potential to be anti-competitive in restricting free movement of farmer suppliers between processors and restricting the willingness of smaller processors to properly compete.
- Incentive payments for increased production push farmers into risk taking activities with very little risk taken on by the processor.
- The ability for downward adjustments to milk prices by processors with no warning leaves farmers disproportionately exposed to risk from market price volatility.
- Loyalty payments in their current state can be used to lock in suppliers that wish to leave by requiring supply into a new contract period before payment is made.
- Milk prices are announced far too close to the beginning date of new contracts, causing problems with farmer budgeting and decision making regarding supply.
- Milk pricing systems are generally too complex for farmers to easily understand with limited time and resources.
- There is no standard definition for weighted milk price mechanisms, they lack transparency, and they rarely represent the true price offered to a farmer.
- The use of an average measure of milk price is inappropriate given the skewing of the average by large farms that receive special prices from processors.
- Inequality inherent within the retail system allows the sale of discount private label dairy product in a way that devalues dairy produce as a whole.
- There is a lack of transparency by processors around milk measuring, milk testing and milk transport costs, all of which could have unfair financial impacts on farmers.

Background

In the initial submission by the UDV to the issues paper of the ACCC inquiry into the dairy industry, we stated that the issues identified within the terms of reference were well focused. UDV still believes that the key concerns regarding the productive operation of the dairy industry are well encompassed by the issues set out by the ACCC, with some minor outliers that we will note.

The following is the full UDV submission to the inquiry, to provide insight into some of the practices currently being used by parties operating within the Australian dairy industry, as well as to direct the ACCC to particular concerns that we believe should be addressed. UDV believes that this inquiry can help to provide fairness, equity and transparency for its members and all farmers and looks forward to the findings of the ACCC when their report is released.

Issues for consideration

Issue 1 – Competition for milk

1. The level of competition between processors for the acquisition of milk, across regions

2. The ability of farmers to switch between processors or other buyers.

The level of competition in Victoria for farmers milk is, in most regions of the state, seemingly very good. There are a number of new, small milk processors that have come into existence over the last few years that provide opportunities to farmers that wish to change company. These smaller processors have been growing in size and growing in number.

To say that competition is good is not true in all regions of the state, however, as we have heard that many remote regions of Victoria have very limited choice for whom to supply. Logistically, these regions have access to only one or two processors due to remoteness and thus struggle for choice.

Additionally, while the presence of smaller processors has allowed some to switch away from companies in some instances, the farmers that are able to do this make up a minority. While these smaller processors do present an option for the farmer and represent competition in the industry, their smaller processing capacity limits the amount of milk they can accept and therefore the number of farmers that can sign with those companies. Once these companies are at maximum intake, they effectively cease to act as competition within the industry. At present the reduced milk production in the state has allowed for more movement to these small processors, but in the case where good production is allowed to occur these opportunities will be limited.

The true concern in examining competition in the Victorian dairy industry is the effect that milk swap deals among milk processors are having on the ability of farmers to move freely between them. The UDV has now heard a number of reports of farmers being unable to switch to their desired processor as a result of a milk swap agreement between two companies. It seems that in some circumstances the company the farmer is trying to switch too would not take the farmer on board as they were concerned about ramifications of upsetting the company the farmer is leaving, whom they have a milk swap deal with. Other reports have big processors refusing to let new leasees of farms join another company, claiming the supply as their own.

The UDV suggests that the general level of competition in Victoria has potential to be healthy and provide a benefit to the industry; however, some tactics being employed by larger milk processors to ensure supply of unprocessed milk are viewed by the UDV as anti-competitive, by restricting the free movement of their farmer suppliers to those farmers' desired processor. These tactics rely on a processor using its size to manipulate or restrict the ability or willingness of other companies to access milk supply and therefore properly compete with the larger processor.

Issue 2 - Contracting Practices

3. The different types of supply contracts used across the supply chain and in certain regions

4. Concerns about anti-competitive conduct or unfair trading practices, including unfair contract terms.

In their current state milk supply agreements and contracts have a number of unfair elements that limit the negotiating power of the farmer and put them at a disadvantage in trying to make the most money for their produce. In considering these contracts and supply agreements, the UDV would like to draw the attention of the ACCC to the ongoing development of a voluntary code of practice for the use of supply agreements and contracts between milk supplies and milk processors. There are a number of elements of the code that will address many of the issues with contracts that are currently used in Australia's milk supply agreements.

Many aspects of current milk supply agreements and contracts allow the processors to lay a disproportionate amount of risk at the farmer's feet, and leave the farmer exposed to financial loss. This risk is based in the provision of incentives for the farmer to alter their production system to increase production in periods of the year that would normally have low yield. These incentives are provided by the processors in an attempt to flatten their milk input curve throughout the year, presumably increasing their own efficiency. In altering the farm system to access these incentives, the farmer begins to take on increased costs of production to meet the demand for milk in periods that would not normally be conducive to high production.

This change in the farming system results in the farmer carrying additional risk associated with any factor that reduces the farmer's production including environmental pressures, feed availability and animal health issues. These unexpected reductions to production can result in the farmer not receiving an incentive payment despite paying an increased cost of production in the attempt to meet their agreed target. The only risk for the processor in this situation is that they do not receive the volume of milk that they desire. Conversely, the farmer is exposed to significant financial loss should the required production volume not be met, having likely put additional funds into feed, animal health and fertility costs, additional labour and other costs in an attempt to reach the specified volume.

Disproportionate sharing of risk in the farmer-processor relationship is further evident in the ability for a processing company to downwardly alter their milk price with no warning, as was seen in April and May of last year and helped to instigate this inquiry. The capacity of processors to drop their price in such a way gives the farmer no time to plan or prepare for the coming season. Late season price changes allow the processor to move all of the short term risk of market volatility onto the farmer. Under the code of practice a processor will be required to give a minimum of 30 days' notice of any downward price adjustment and allow the farmer to make preparations for the lowered price, or give the farmer time to seek an alternative processor and switch supply without reprimand.

The use of Loyalty payments represents another issue in contracting practices. Loyalty payments are, on paper, a method of rewarding a farmer for providing their milk to a single processor for the duration of the contract term. The use of loyalty payments has evolved from payments that were made to farmers at the end of each year to reconcile the amount paid by the processor with the amount of milk that was collected. At some stage over the last few years this process has been replaced with the current system, whereby the factory promises an extra payment at the end of the contract term. This would seem like a bonus for the farmer; however the way that these bonuses are instituted can be manipulative and used to lock the farmer into continuing supply for the following year. Many farmers have reported that they will not receive a loyalty bonus unless they continue to supply the company until the final milk payment is made. This does not give the farmer time to switch supply to another company before the start of a new contract period, thus they would miss out on any other loyalty payment being offered. This fear of missing out on a substantial financial sum by the farmer results in the processor retaining the supply for the following supply period, regardless of whether the farmer wishes to change processor.

Issue 3 - Transparency and price signals

5. How farmgate milk prices are set and communicated to farmers

6. The availability and use of meaningful global market information and price signals across the industry, including by dairy farmers.

In order to properly budget for farm activities, farm owners need an accurate understanding of their potential income. This income varies throughout the year with various sized price adjustments. Adjustments are planned for as best as is possible, however all planning is based on communication from milk processors.

In many cases, the opening milk price offered by a processor gives the farmer a conservative beginning price on which to base their budget for the year. It also gives the farmer the opportunity to decide which milk company can provide the best price for their milk. At present, there is no standard for how and when milk companies communicate this information to farmers. In some situations opening prices are not announced until very close to, or after the start of a contract period. Beside the implication of this late notice for incentive payments and farmer movement to other processors, receiving pricing information so close to the beginning or even after the start of a contract period leaves farmers unable to plan for the coming year and can leave them in a state of uncertainty as to the coming season.

This inconsistency also causes great difficulty in comparing processor price offerings. This, coupled with the use of complex pricing systems, leads farmers to spend valuable time and effort on trying to discover their potential earning at any given company before being able to compare them and make an informed decision about which company can provide them the best price.

At present, it is common for milk price announcements to take the form of a Weighted Average Milk Price. Weighted Average price is an incredibly confusing factor in the modern Australian dairy industry; there is no standard for the formulation of this price, and there exists no information for farmers as to where they sit in relation to the average. The weighted average is further distorted by special prices offered to desirable farmers by milk companies. Many of these farmers are provided special prices due to their very large milk output, geographic location or proximity to other specific producers, or other reasons, which when coupled with an increased price can greatly confound an average milk price. The skewing of the average price results in the majority of farmers being paid less than the weighted average price communicated by farmers, forcing farmers to budget more conservatively and further restricting their capacity to invest in their own businesses.

Proper evaluation of a weighted milk price is beyond the ability of the UDV or any other organisation short of the milk processing companies themselves. Without access to confidential information regarding farmgate prices paid to dairy farmers, we are unable to ascertain what proportion of farmers are receiving below the reported weighted average price and by how much they are being underpaid. This inability to know the value and efficacy of the weighted average only furthers the lack of transparency that surrounds this measure and limits the ability of representative organisations to properly understand and comment on processor reporting, let alone farmer suppliers. Therefore, UDV asks that the ACCC use its investigative powers to carry out an examination of the proportion of farmers that fall below the reported weighted averages and that they include a summary of the results in their report to the treasurer.

UDV would like to see the weighted average milk price replaced. It is possible a median price or similar pricing signalling mechanism would better represent the price presented to farmers, but whatever form the mechanism takes, it is imperative that any price signalling system should be transparent and prices that are communicated are able to be verified as being a true representation of prices paid to farmers.

The weighted average milk price is only one part of the confusing milk pricing system that should be reviewed. As a result of a discussion group undertaken in 2013, UDV identified that at that time there were more than 30 individual points of differentiation within the Victorian milk pricing system across all processors. Farmers have reported that in some situations this has led to a difference of more than a dollar per kilogram of milk solids offered to farmers supplying the same company. These claims are supported by a UDV study of 2014/2015 western Victorian milk prices, which showed variations of between 30 and 64 c/kg MS offered to three average model farms by individual processors. In some cases this accounted for a 10% variation to the milk price offered. These drastic differences can have multiple effects on the milk supply and profitability of farms, but ultimately disadvantage select farmers by reducing the value of their milk while others are paid a price that allows for proper operation and continuing reinvestment. In particular, price variation often advantages larger, established farms, leaving new entries into the industry on the lower end of the milk pricing scale. UDV is more than happy to supply the results of both the milk price study and the discussion group should the ACCC wish to review them.

Much of the uncertainty that is felt by farmers when considering milk prices has to do with the need for milk price adjustments. It may be that these adjustments are necessary, but UDV questions the need for milk price adjustments at all. The case for the use of price adjustments is reduced by the fact that multiple milk processing companies are currently managing to provide flat milk pricing structures to farmers. Parmalat, Australian Consolidated Milk, and DFMC all provide flat pricing options.

Milk processors in Victoria have many different product mixes which they sell into different markets including both domestic and global marketplaces. This difference in product mix must presumably result in different income profiles as a result of variations in global and domestic dairy mixes, and the difference in prices offered for different products. This diversity in income profiles is not reflected in the farm gate price returned to the farmer, where the price offered by any given processor is very similar to any other. Once the Victorian milk cooperative has announced its opening price, it is common for most companies to announce a price slightly adjusted from the cooperatives. Many processors state as much in their contract terms. We would expect to see more variation in milk prices offered to farmers from different processors if these prices were a true representation of the value of the milk to the processors given the different product mixes and markets involved. Given fluctuations in global milk prices, however, returns from processors that exclusively export to overseas markets tend to remain relatively stable compared to the global milk price.

Issue 4 - Domestic retail markets

7. The major supply channels for the domestic market, including major supermarkets and other retailers

8. The impact of $1 per litre milk on the industry. This includes information about the positive and negative impacts of private label product supply contracts.

It is clear that discount private label dairy products are causing major issues in the dairy industry throughout Australia. The proportion of milk produced in Victoria that is sold as private label drinking milk is much lower than in other parts of the country, and therefore has a lower impact on the price paid to the farmer. It is, however, a worrying practice that has harmed the Victorian dairy industry by reducing the value of liquid milk sold throughout the retail sector. What is even more worrying for Victorian dairy is the extension of these pricing practices to cover the broader range of dairy products. The greater value of the dairy cabinet of products comes from cheese production which is now being sold at major supermarket chains for 60 cents per kilogram or less and other dairy products. This reduction in retail value has undermined the public perception of what dairy products are worth, weakening the margin being paid back to milk processors who are forced to pass these losses on to their farmers. Whilst one dollar per litre milk has become the catch cry of the cause against discount dairy product, other discounted private label products such as cheese have been reported to be returning even worse margins to the processors and it is important that these other discount products be the focus of any investigation into supermarket behaviours.

UDV holds much hope for the application of the effects test legislation. The abundance of private label discount dairy product is representative of a much larger inequality in the dairy supply chain beyond the contracting practices of milk processors. Removal of the value of these dairy products at the point of sale by supermarkets in this manner is responsible for a portion of the hardship felt by farmers in the current climate, but represents an even more worrying future for Australian dairy as these practices are extended to cover more of the range of retail dairy product. UDV holds hope that application of the effects test may give regulatory bodies such as the ACCC the powers to properly investigate large retailers and make recommendations based on the negative effects they are wreaking on the industry, as opposed to the retailers claims that they have been acting in in the interests of all stakeholders.

Issue 5 - Global markets

9. Options for supply into export markets, including products and destinations

10. Any barriers to selling into export markets.

At present, the ability to export Victorian dairy product into overseas markets is in a favourable state. In fact the majority of Australian manufactured product is sent into the global market. The ability of Australian farmers to access international markets is largely sustained by the presence of free trade agreements that allow access to markets in countries like China where demand for high quality produce is great. Despite these FTAs' there are quite a number of tariffs and other social and cultural barriers that limit access to these markets to varying degrees. The dairy industry is doing significant work with our trading partners on these barriers and the UDV expects that the best way for these barriers to be overcome is to continue to build strong relationships with our trading partners in order to increase confidence in our high quality product. Therefore we would encourage all involved with this inquiry to make sure that any result of the inquiry process and resulting action by the government should not impact upon those relationships in a negative manner.

Issue 6 – Production costs and profitability

11. The key factors influencing the profitability of dairy farms, including costs of production.

A key factor that has affected farm profitability over the last decade has been production cost and low milk price itself. The low milk price that has been felt by farmers has a twofold effect on profitability. Firstly, and more obviously, the price directly affects the income that a farmer earns, lowering their profitability in the short term. This has a further effect over a long period, as this lowered price can affect the long term production efficiency by placing upward pressure on the farms cost of production. As a low milk price is continuously imposed on a farmer, that farmer begins to prioritise their spending, cutting the fat, and operate in an increasingly conservative manner. Over a short period of time, this can allow the farmer to save enough debt to be able to capitalise on a good milk price when it comes.

However, if this good milk price does not come soon enough the farm begins to lose efficiency due to reductions in continuous investment in maintenance spending and reductions to herd size and health in an effort to save money. The danger is that if a farm finds itself and its herd in a state of less than optimal efficiency once a good milk price is presented, the farm may not be in a state to make efficient use of the better price and struggle to become truly profitable. The result is a farm struggling to clamber back into a state of profitability rather than making gains and reinvesting in the business, preparing for another difficult year should it present itself. As is the case over the last dozen years, these low income or high cost years have occurred regularly enough to place a significant number of farmers into this cycle. A fair price has potential to go a long way toward breaking this cycle, allowing farmers enough of a margin to address issues of inefficiency within their own systems and allowing them to better deal with challenging years that will likely occur all too soon.

Whilst the Victorian Milk Price is linked to the export global price for a particular basket of dairy goods (WMP, SMP, Butter, Cheese etc.) it is fair to say that the transparency around the profitability of the whole supply chain from farm gate to market is a concern. It is fair to say that the lack of stability and disproportionate risk being born at the farm gate is stifling capital inflows into the industry. Even larger investment companies have little foresight over pricing going forward setting a tone of reluctance to invest.

The industry has some unique resources and opportunities, but if Transparency and risk across the whole supply chain is not dealt with then we may see minimal growth going forward. With the loss of the Australian co-operative dominated landscape and the rise of the corporate processing sector, we have significant risk related to the senior management executive churn. We are seeing very short sighted decisions which may increase competition in the short term but a lack of understanding from the processing and retail sector and some of agricultural production systems could be related to the eroding profitability and re-investment in the pre-farm gate farming sector. Therefore a whole supply chain vision for the Australian dairy industry should be sought to ensure the market is working correctly and everyone is enjoying the spoils in the sector.

Other Matters

12. Milk measuring, Milk sampling, Processor Arrangements.

Further to the issues identified by the commission in their issues paper, the UDV would like to draw the attention of the ACCC to a number of other points.

As has been mentioned in other sections of this submission, processor collusion appears to be occurring among milk processors throughout the state of Victoria. This has already been referred to regarding the use of milk swap deals that are restricting the free movement of farmers to switch processors.

Of further interest is the issue of a potential monopoly by one milk sampling company. Concerns about the use of only one company for the testing of milk quality for the majority of milk collected in the state were raised at the public forum in Shepparton, and the UDV would like to support this issue being included in the current investigation. The use of only one laboratory for the testing of milk quality leaves the industry in a position where any inaccuracy affects the majority of farmers in Victoria, along with the potential monopolistic problem of a sole business providing a service to almost an entire industry. The UDV understands that the ACCC intends to investigate this issue, and supports examination of the current arrangement and quality controls regarding milk testing to ensure farmers are being properly rewarded for their high quality produce.

The UDV also asks the ACCC to consider milk measuring as a matter to be examined. Dairy farmers sell tens of thousands of litres to processors each week, and the price paid to each farmer is heavily affected by the volume recorded. At the time of each milk collection the volume of milk received from the vat is measured and recorded; this volume is the basis of the total price paid to the farmer, as well as the calculation of the volume charge. A small level of inaccuracy within this measuring system can result in a very large discrepancy when a whole years' worth of milk production is considered. An inaccuracy of 1% on milk volume represents a potential loss of thousands of dollars to an average farm.

Finally, UDV would also like to raise questions about the cost of milk transportation in the dairy industry and what could be perceived as unfairness in the application of transport charges. It is accepted that common milk transport charges for all farmers supplying that same processor exist, regardless of distance from the processing factory. However, the blanket approach to milk transport charges becomes unfair when exceptions start being made for large suppliers as a form of incentive, reducing the per litre cost to the farmer. These exceptions are based on improved efficiency for the processor by reducing the number of stops required to fill a tanker, however, the application of a standard milk transport charge to new, smaller farms while larger established farms are receiving a special transport charge could be seen as disadvantaging these new farms as they enter the industry. Additionally, the formulation of these milk transport charges is not sufficiently transparent. There are costs associated with milk traveling from farm to factory as well as away from the processing plant. Farmers are under the understanding that they are paying the price for transportation to the factory; however there is no way to be sure that factories are not covering other costs in part via these charges.

Conclusion

The Australian dairy industry supply chain in its current state is an unfair, broken system. Many of these problems are occurring during the sale of milk from the farm gate to the processors. Further problems are obviously occurring in the dealings between processors with retail sellers. The UDV believes that these problems, if addressed in a timely manner, can be amended and the dairy Industry restored to the profitable, productive system it has been in the past. Therefore, UDV asks the ACCC to address the following:

The use of milk swap deals and potential intimidation tactics by processor contain aspects that could be seen as being anti-competitive and unfairly limiting the free movement of farmers between processors. UDV asks the ACCC to look into these practises.

Keeping in mind the current work going into a voluntary code of practice for agreements between farmers and processors, UDV would like to urge the ACCC to thoroughly examine contracting practices between processers and their farmer suppliers. Of key concern are the use of incentive payments and loyalty payments in a manner that disadvantage farmers, as well as the lack of restrictions that allow unforeseeable farm gate milk price decreases.

UDV would like to see this thorough examination extended to milk pricing transparency, especially the appropriateness of weighted average milk price and the timeliness of pricing communication by processors.

There are major issues present in the retail sector in relation to discount private label dairy products, notably including cheese and drinking milk. While UDV understands that there are limitations to the powers given to the ACCC in this inquiry in this matter, we urge that the actions of supermarkets be investigated to the fullest extent possible.

UDV would also ask the ACCC to consider matters of transparency around milk measuring; milk testing and milk transport charges and ask that they be included in this inquiry.