

NARGA



The challenge to feed a growing nation

November 2010

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John Cummings

NARGA Chairman's Analysis

There have been many inquiries into aspects of the Australian grocery industry, including the report of:

- the House of Representatives Standing Committee on Industry, Science and Technology (the Reid Committee, 1997),
- the report of the Joint Select Committee on the Retailing Sector (the Baird Committee, 1999),
- the ACCC's report to the Senate *On prices paid to suppliers by retailers in the Australian grocery industry* (2002),
- the *Review of the Competition Provisions of the Trade Practices Act* (the Dawson inquiry, 2003),
- the Senate Economics References Committee inquiry into *The effectiveness of the Trade Practices Act 1974 in protecting small business* (2004),
- the *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (2008) and various Senate Economics Committee inquiries,
- most recently the *Senate Economics References Committee's report on dairy pricing* (May 2010), *Milking it for all it's worth - competition and pricing in the Australian dairy industry*.

The frequency of these inquiries suggests that there are issues which remain unresolved, issues which continue to cause problems for Australian primary producers, processors and manufacturers, retailers and consumers.

This report reviews the entire food and grocery supply chain from paddock to plate. We believe this has been the first report to gather hard data on the entire supply chain.

The result is a clear picture of an industry facing serious issues: without concerted action by government, Australia risks losing its domestic food industry as we currently know it.

The National Association of Retail Grocers of Australia commissioned Accenture Australia to conduct this research because we have grown increasingly concerned that the country with the cleanest paddocks in the world is importing more

and more food and at the same time creating conditions which will make it difficult for primary producers and manufacturers to remain viable.

We believe this is being driven by the unparalleled hyper-concentration of the grocery retailing sector, where two major supermarket chains have almost 80 per cent of packaged grocery sales. By comparison, the two largest grocery retailers in the United States (Wal-Mart and Kroger) jointly have 20 per cent market share and the top five chains in the United Kingdom have about 80 per cent.

Governments have not to date acknowledged that the level of market concentration in the Australian grocery retailing industry has been adversely affecting the ability of many Australian primary producers to survive - the dairy farming sector is a case in point, as the Senate Economics References Committee reported earlier this year - and processors and manufacturers are being forced to bulk up through mergers and acquisitions to give themselves some hope of negotiating fair deals with the major retailing chains.

These are the types of issues which were acknowledged as early as 1997 in the Reid Committee's report *Finding a balance: Towards fair trading in Australia*. The problems remain today, but are more urgent. Piecemeal amendments to the *Trade Practices Act* have been ineffective.

The ACCC's 2008 grocery inquiry report found that Woolworths and Coles were only "workably competitive". We think that was far too bland a conclusion: they merely share the market and exert enormous power over their suppliers, their competitors and their customers, not through efficiency or economies of scale, but simply because of their dominant position in the market.

There are a number of indications in this report suggesting that the retail grocery market may not be genuinely competitive. These include:

- The disparity between volume and value growth during the last decade (12 per cent versus 42 per cent) that suggests an increase in profit margins taken at the retail level; (see page 13)

- The margin shift from producer to retailer - in the dairy sector, retailers take 80 per cent of the available gross profit, processors 16 per cent and farmers four per cent; (page 43)
- The high degree of concentration of the retail grocery market with Woolworths and Coles identified as having a market share of around 80 per cent between them; (page 27)
- The fact that Australia has a more stable retail growth pattern, less affected by the type of fluctuations that would be expected as a result of greater price competition; (page 21)
- The evidence of a 'waterbed effect' in prices paid by independent retailers, of which the dairy industry is an example. This results in suppliers being forced to charge higher prices to some customers for some products in order to compensate for lower prices being paid by the major chains; private label milk prices offered by the major chains have been offset by significant price increases for cheese, yoghurt and ice cream in the past few years; (page 43)
- Growth in the lower quality private label market suggesting there is insufficient competitive pressure to maintain product quality (pages 16, 46).

The expansion of the major chains' private label ranges in recent years has seen an increase in imported products from low-cost countries. As a consequence, Australian primary producers and manufacturers have lost domestic market share.

This report highlights some of the problems which are evident in the market:

- Food consumption is growing faster than population
- Food consumption is growing faster than food production
- Food imports are growing faster than food exports
- Grocery industry growth has outpaced both gross domestic product and overall retail growth in the second half of this decade
- Grocery prices are growing faster than the consumer price index (and, because they constitute a significant part of the CPI, contribute to increasing the CPI itself).

If these trends continue, substantial parts of Australia's domestic food industry are at risk.

There is no simple, single remedy for the problems facing the Australian food and grocery industry.

However, it is clear that the market concentration of the Australian grocery retailing sector needs to be addressed so that the market dominance of two major companies can be reduced over time.

One way of ameliorating the market power of the major chains is the reintroduction of a prohibition on anti-competitive price discrimination - a circumstance where suppliers, willingly or unwillingly, are obliged to sell product to one (or several) customers at lower prices than are available to other customers, discounts that are unrelated to genuine discounts for economies of scale.

However, the advantage gained by anti-competitive price discrimination at the point of supply cannot be recovered by other competitors, even if they accept a lower profit margin. The result is a heavy dampening of competition and, over time, further market concentration.

When the *Trade Practices Act* was passed by the Parliament in 1974 it contained such a prohibition, the then section 49, but after a sustained campaign by big business, it was repealed in 1995.

Interestingly, the campaign by big business began almost immediately after the *Trade Practices Act* 1974 was passed and before any cases had been taken to court. The big business campaign was reflected in the recommendations of the Swanson Committee as early as 1976. The Blunt Committee repeated the recommendation in 1979. The campaign continued until the Hilmer Committee's recommendation of repeal was acted on in 1995. Yet the Trade Practices Commission did not take a single case to court from 1974 to 1995.

It is now extremely clear that the assumption by the Hilmer Committee, echoing the Reid Committee and many others since - that a prohibition on anti-competitive price discrimination was unnecessary because section 46 of the *Trade Practices Act* (dealing with misuse of market power) could be used to address such conduct - was wrong and unsupported by any evidence whatsoever.

Again, since the repeal of section 49, the ACCC has never used section 46 of the TPA to test allegations of anti-competitive price discrimination in court.

That is a matter of record. Yet many small businesses, particularly in the grocery sector, have also said publicly that they cannot buy product at wholesale cheaper than the major supermarket chains ask for the identical product at retail. That circumstance has nothing to do with economies of scale.

We believe the reintroduction of a prohibition on anti-competitive price discrimination is now critical.

Australia and New Zealand are now the only two OECD countries without such a prohibition, resulting in a situation where the major supermarket chains, amongst other big corporations, are able to demand pricing advantages which suppliers could not deny them without risking the loss of one or other of their two largest customers, potentially to be replaced by imports.

However, without a regulator committed to active monitoring of industry and application of the legislation, black letter law is largely irrelevant. The failure of regulatory commitment was noted as early as the 1997 report of the Reid Committee and is evident from the failure of the Trade Practices Commission or the ACCC to take a single allegation of anti-competitive price discrimination to court since 1974, under either section 49 or section 46.

NARGA supports the recent observation by the Australian Food and Grocery Council that a whole of government response is needed to resolve the issues now facing the food industry.

This would allow governments to engage with the individual sectors in the supply chain, beginning with the farming sectors which currently seem most at risk. NARGA believes Australians need and want a vibrant and secure farming sector.

Processors and manufacturers require continuous reinvestment in their Australian facilities. Without such reinvestment, Australian operations of international companies are also likely to be at risk and governments need to understand that and create a climate of confidence for such investment.

Finally, governments need to understand that the independent grocery retailing sector is the major source of competition for the major chains. Independent grocers offering a wide range of formats and market specialisations are the best defence for a competitive industry.

Governments need to acknowledge that the threats to the continued viability of the Australian food industry stem from the hyper-concentration of the retail sector and, as the inquiry reports listed earlier indicate, there has been a long-term failure of the regulatory framework to address such issues.

JOHN CUMMINGS

Chairman

National Association of Retail Grocers of Australia
November 2010





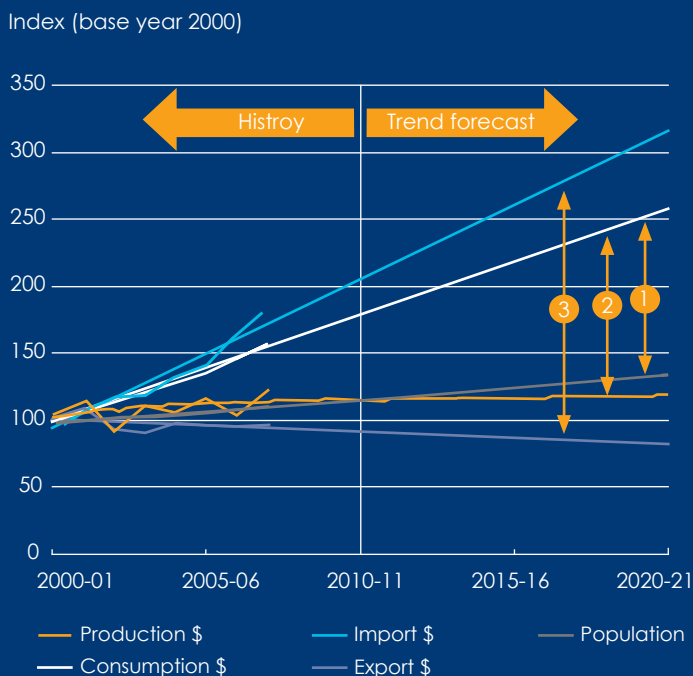
2. Australian food sustainability at the crossroads

The current, wide-ranging debate that focuses on sustainability of "big" vs. "small" Australia has a parallel in the local food industry. The trends over the last decade potentially signal the fact that we are facing a significant tension point in regards to long term sustainability of local food production that is able to effectively satisfy our consumption patterns.

There are three linked trends that, once extended into a forecast, point to this:

- 1. Food consumption is growing faster than population**
- 2. Food consumption is growing faster than food production (which is in decline)**
- 3. Food imports are growing faster than food exports**

Fig 1. Australia - Food Supply and Demand Trends and Outlook



Sources: Australian Food Statistics Report 2008, Processed Food manufacturing. Data have been indexed on year 2000 and linear trendline have been applied.

Food Consumption is growing faster than Population.

Whereas population in Australia has increased by 11 per cent over the last decade, our 'per capita' food consumption value and volumes increased by 58 per cent and 25 per cent respectively.

Food Consumption is growing faster than Production.

Although food production has increased by 21 per cent in value terms since 2000, the volume of food production at primary level has actually decreased by 11 per cent since 2000. Both of these are well below the pace of growth of population or consumption.

It is evident that the current trends, if allowed to continue unabated, may create significant challenges in regards to the feasibility of local industry effectively supporting the domestic demand, as well as creating a potential flow-on effect to increased reliance on food imports to bridge this gap.

In fact, this trend of **food imports growing faster than food exports** is already evident in the data from the past decade. Food exports values have actually slowly eroded (-4 per cent) whilst food imports values have increased by 80 per cent in value between 2000 and now. This pattern is even more evident with data that is volume based with the imports to exports index gap widening further.

These tension points raise questions as to whether the Australian food industry is optimally positioned to face these challenges, in view of current changes and trends in regards to its structure. We will now look in more detail at these cumulative trends that create this tension point.

2.1 Australian population trends

Between 2000 and 2009, population in Australia grew from 19.2 million to just over 22 million, an 11 per cent increase.

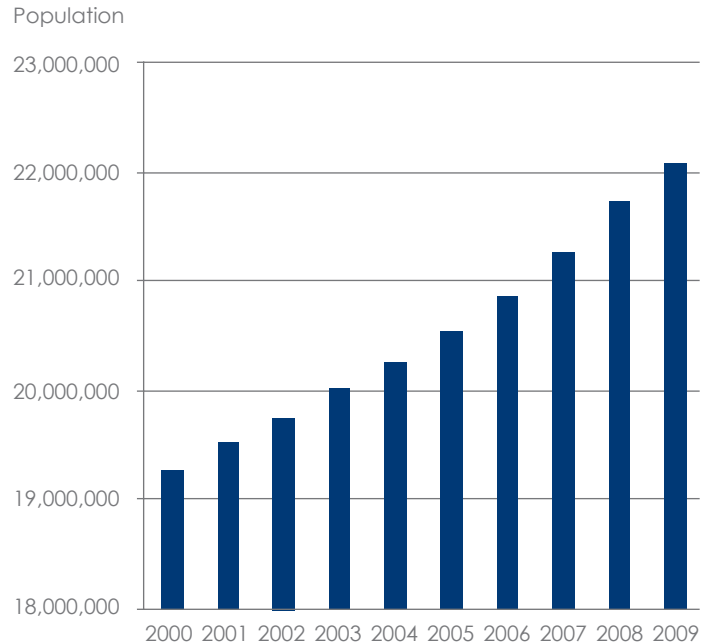
Latest official ABS projections for population range from 30 million to 40 million by 2050, depending on the scenarios (low/high fertility, life expectancy, overseas migration). This could represent a near doubling of our current numbers.

This population increase and the future projections need to be considered in relation to their effects on our food consumption rates and patterns, as well as how well the Australian food industry is poised and structured to support them in the near future.

They also need to be considered holistically across the “paddock to plate” value chain at production, processing and retail components, and structure and trends in the Australian food and grocery industry.

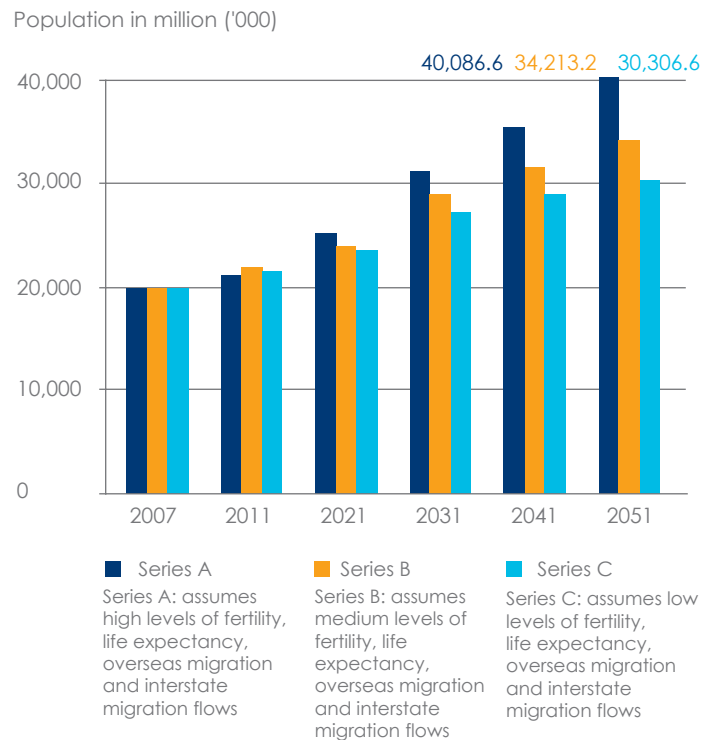
Let's turn our attention first to the food consumption patterns.

Fig 2. Australian population trend (2000-2009)



Source: ABS table 3101.0 'Australian demographic Statistics'.

Fig 3. Australia Projected Population in Millions (2007 to 2051)



Source: ABS catalogue 31010DO001_200909 Australian Demographic Statistics, Sep 2009, Table 9 Projected resident population, states & territories.

2.2 Australian food consumption trends

Our food consumption continues to rise at a pace that is outstripping the population and GDP growth rates, thus creating pressure and additional demand for local fresh and processed foodstuffs.

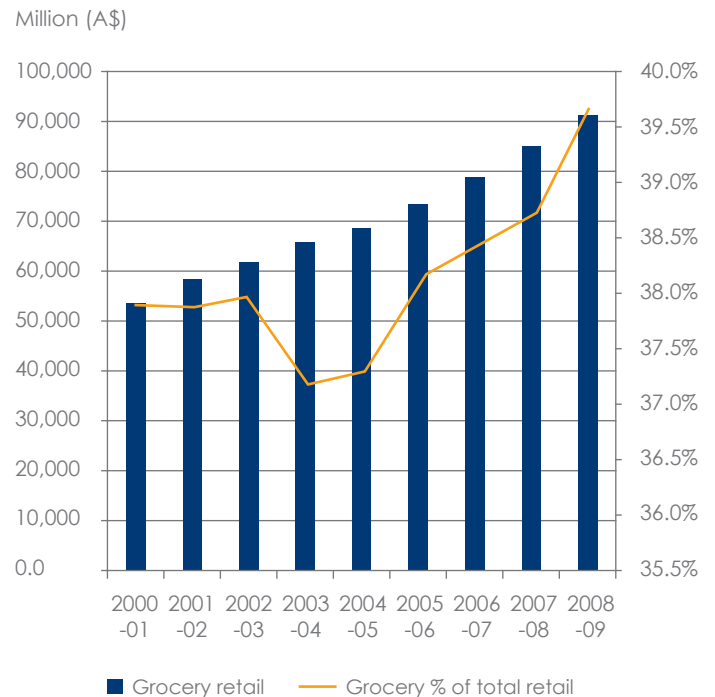
Australians continue to consume more per capita and this is reflected in the growth of grocery retail turnover figures - the best data proxy for our food consumption - which have increased by 70 per cent since the year 2000. (Source: ABS catalogue 8501.0 'Retail Trade, Australia'. Table 11. Retail Turnover, state by industry subgroup)

When we indexed consumption growth trends vs. population in the last decade, two key insights were uncovered to support this trend:

- **Consumption volumes have grown 12 per cent faster than population in the same period of time**
- **Consumption values have grown 42 per cent faster than population in the same period of time**

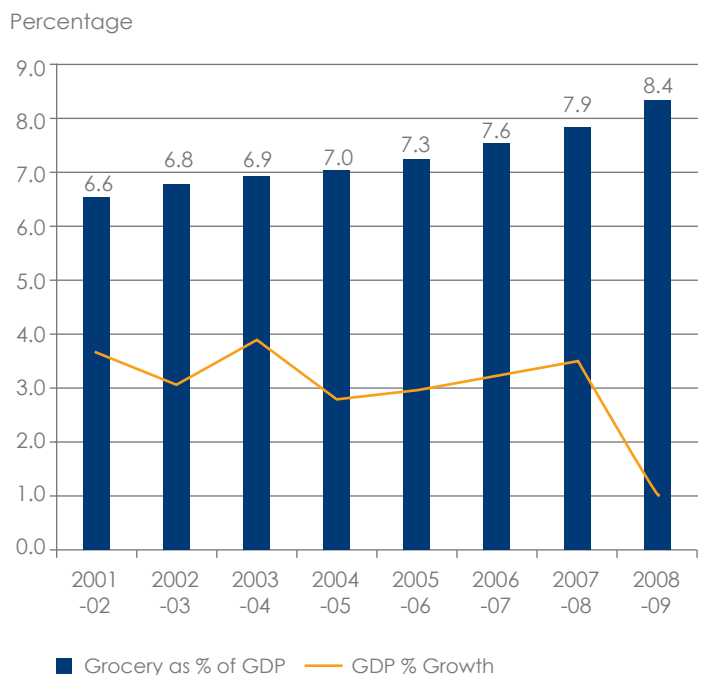
Grocery retail has grown faster than GDP, reflecting the fact that the per capita demand for food is on the rise, but also potentially linked to the diluting factor that grocery retailers are including more categories in their portfolio to drive overall demand.

Fig 4. Grocery Retail Turnover Trend (2000-2009)



Source: ABS catalogue 8501.0 'Retail Trade, Australia'. Table 11.

Fig 5. Grocery Retail Share in GDP (2000-2009)



Sources: ABS catalogue 8501.0 'Retail Trade, Australia', table 11, Retail Turnover, state by industry subgroup. ABS catalogue 1350.0, Australian Economic Indicators, Aug 2009, table 13500DO001_200907.

2.3 Australian primary production trends

Food production volumes are linked to many factors – ranging from weather patterns, through legislative and regulatory initiatives to the effects of global trade and commodities demand patterns, as well as local demand requirements. As such, isolating any one of these as the overriding factor that drives the end volumes and values is an inexact science at best.

What we are focusing on here are the overt facts related to the observed end patterns in production values and volumes and how they relate to the wider trends in the “paddock to plate” food industry in Australia.

At top line summary, the Australian food production patterns in the last decade indicate:

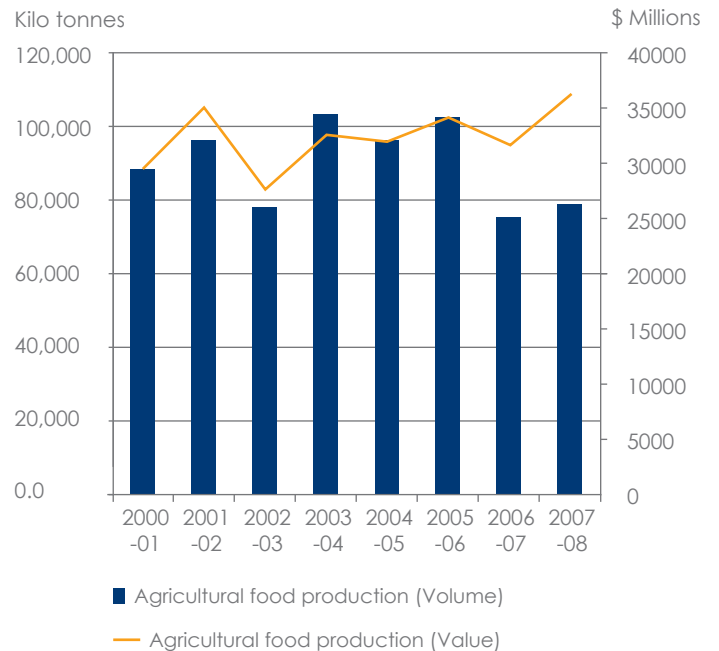
- Value rise of 21 per cent over that period in time
- Volume decrease of 11 per cent over that period in time

These trends lag behind population growth trends and more importantly consumption volume trends for Australia. This means that Australian food export revenues will be negatively impacted to allow for diversion of local production to satisfy local demand.

As indicated, these trends may also reflect drought conditions and climate variability that have been observed in Australia in recent years. [Drought is already over in most places]. At a more detailed level we can see the patchy volume growth patterns across some of the key commodities:

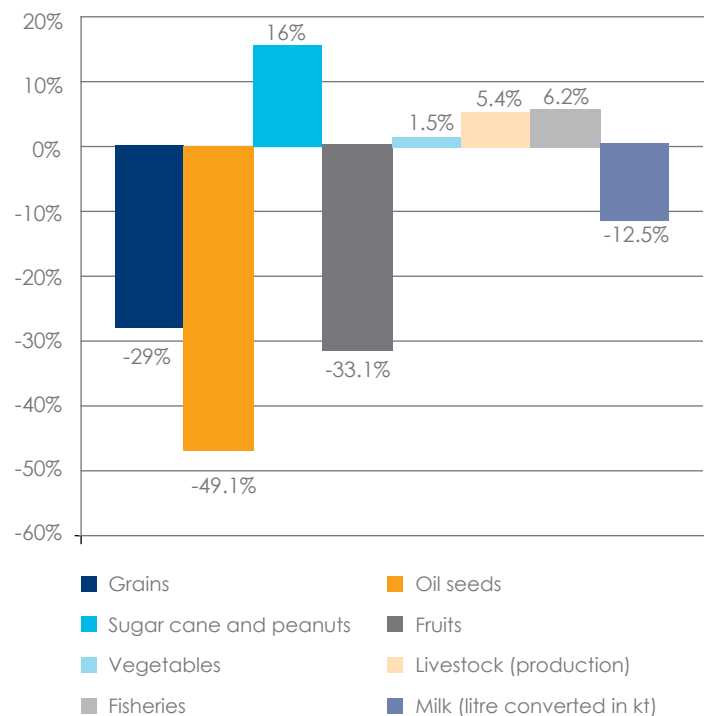
- Positive growth – Sugar cane
- Marginal growth - Fisheries, livestock and vegetables
- Negative growth - Grain, oil seeds, fruits and milk

Fig 6. Australia agriculture food production trends (2000-2008)



Source: Australian Food Statistics Report 2008, Agricultural Food production by commodity.

Fig 7. Australia - Agricultural Food Production Volume Trends (2000-2008)



Source: Australian Food Statistics Report 2008, Agricultural Food production by commodity.

2.4 Australian processed food production trends

The trend of lagging behind consumption demand growth gets more pervasive when we shift our attention to the processed food sector in Australia.

Only two categories seem to be keeping up with consumption growth rates in regards to production rates. As such, the overall 37 per cent growth in value between 2000 and 2009 for food production is not high enough to sustain local consumption growth rates. This signals the slowdown in the rate of expansion of local manufacturing capacity as well as the slowdown of production efficiency and product innovation rates to keep up with local consumption trends.

As such, local production may need to be supported by further imports to close the gap with projected consumption levels.

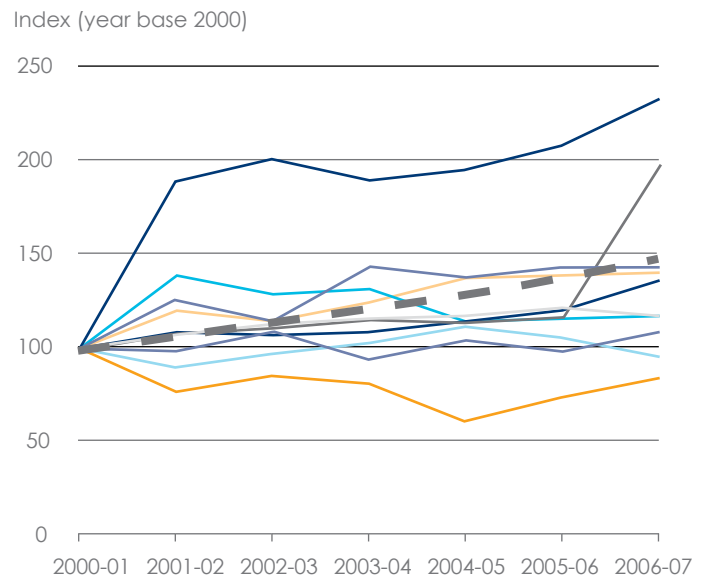
When we extend the current index patterns forward, and use the consumption growth rate as the reference point, further detail emerges:

- Sugar & confectionary and bakery products are the only two groups that are growing at a faster rate than consumption
- Oil & fats manufacturing is declining not only in regards to keeping up with the growth of consumption but also in absolute terms
- The remaining commodities are not keeping up with the growth of consumption and will need to be supported by imports to satisfy local consumption growth.

These trends once again underline the apparent divergence between local consumption growth rates and the changing way that the industry is currently poised to support it locally.

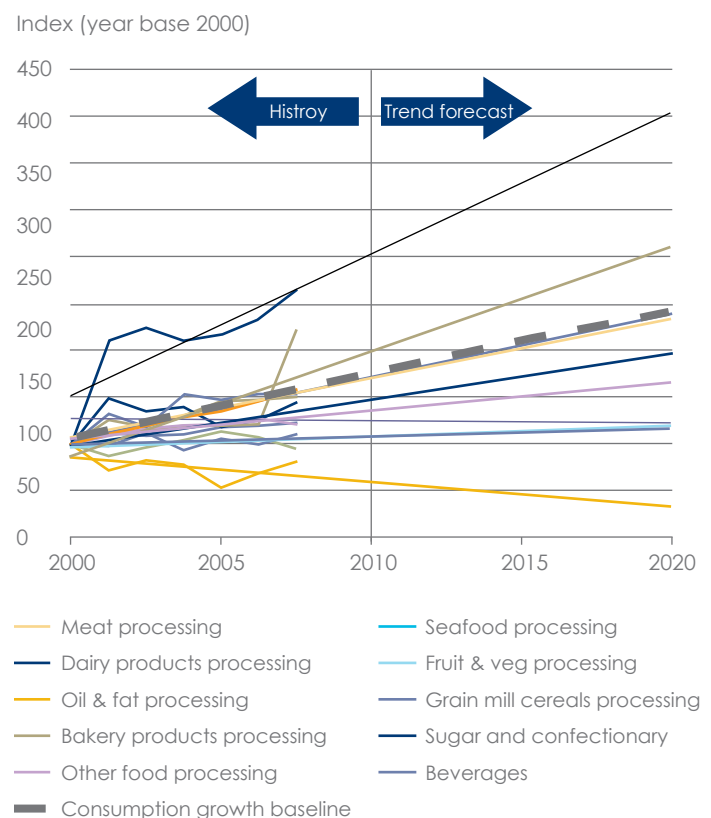
The last piece of the trends puzzle – the imports vs exports trend - suggests that if these patterns continue the solution to this divergence will not lie in increasing local capacity, but rather on increased reliance on imports. The question remains whether this is the right solution for our market and industry.

Figs. 8 and 9. Processed Food Manufacturing (Index Value)



Source: Australian Food Statistics Report 2008, Processed Food manufacturing (values have been indexed on year 2000).

Outlook



Sources: Australian Food Statistics Report 2008, Processed Food manufacturing. Data have been indexed on year 2000 and linear trendline have been applied.

2.5 Australian food exports and imports trends

Over the last decade – there has been a clear divergence in food exports and imports patterns:

- **Food Exports are in decline** – decrease in value (-4 per cent) and volume (-40 per cent) between 2000 and 2009
- **Food Imports are on the rise** – increase in value (+80 per cent) and volume (+94 per cent) between 2000 and 2009

Further analysis reveals that the contribution of food exports value to total Australian exports has declined from 18 per cent in 2000 to 8 per cent in 2009 – this is a 55 per cent share decrease in one decade.

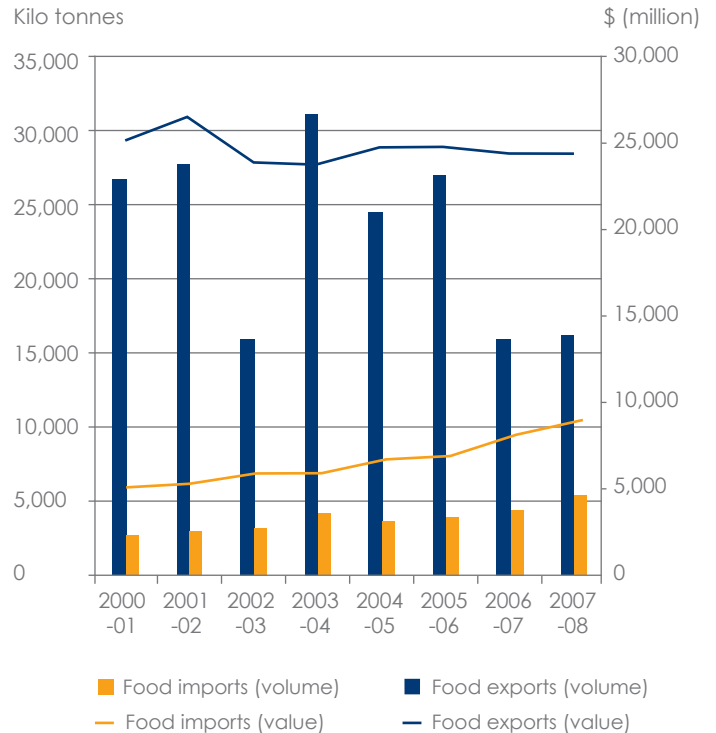
As such, it is evident that the current trends and projections for population growth and increasing consumption, combined with local food production that is declining in volume terms have the effect of:

- Transferring some of the potential export volumes to local consumption
- Increasing the import volumes to close the consumption gap

In addition, current Australian currency strength is putting further pressure on local producers to stay competitive with imported foods.

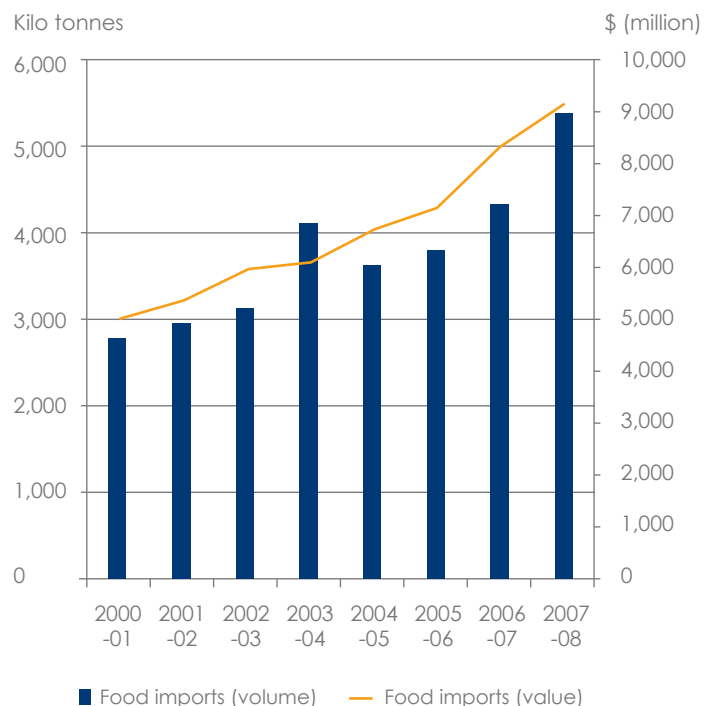
Lastly, it suggests that overseas sourcing for food products is increasingly used as a long term alternative by the food processing and grocery retail industry in order to maintain all year long supply in the market and bridge the gap to growing consumption.

Fig 10. Food Imports and Exports Trend



Source: ABS catalogue 5368.0 International Trade in Goods and Services, Australia, table 12a and 13a used for export & import value. ABS unpublished catalogue used for import and export volume.

Fig 11. Australia - Food Products Imports Trends



Source: ABS catalogue 5368.0 International Trade in Goods and Services, Australia, table 13a used for imports value. ABS unpublished catalogue used for imports volume.

2.6 Food industry sustainability dilemma

As demonstrated, the Australian market is displaying a number of trends that are putting pressure on the long term sustainability of the "paddock to plate" food industry in this country.

We are facing a paradox where we have a growing population and growing per capita food consumption that is contrasted with decrease in local primary as well as processed food production and exports, resulting in growing imports to bridge the consumption gap. It seems that the local industry is not responding to the demand growth signals of a market economy, in fact it seems to be going in the opposite direction.

There are questions that come to mind as to what is driving these patterns and why it is happening:

- How important is the food industry to the Australian economy?
- What is the current size and structure of the industry at primary, manufacturing and retail level?
- What is the level of concentration and competition across the food chain ?
- What are the current trends and issues faced by the players in the food chain in Australia?
- Is concentration in the retail sector also resulting in concentration in other sectors of the food chain?





3. Australian grocery industry - context and structure

The grocery industry is the key channel for food distribution and consumption. It is the single biggest retail sector and makes up 39.6 per cent of total retail turnover in 2008-2009 (ABS Catalogue 8501.0

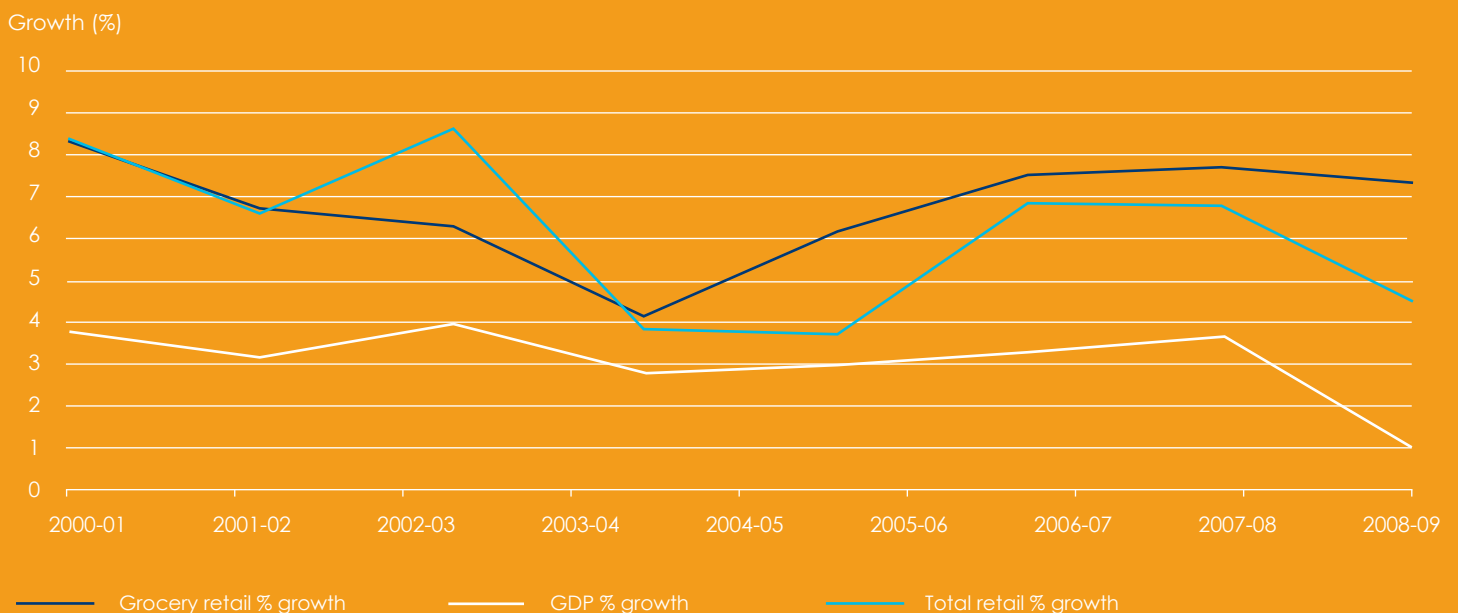
'Retail Trade, Australia'. Table 11). It has registered a 70 per cent growth in the last decade and forms 8.4 per cent of the total Australian GDP, 27 per cent share growth in one decade.

Fig 12. Grocery Retail Turnover Trend (2000-2009)



Source: ABS catalogue 8501.0 'Retail Trade, Australia'. Table 11.

Fig 13. Grocery Retail Growth (2000-2009)



Source: ABS catalogue 8501.0 'Retail Trade, Australia'. Table 11. Retail Turnover, state by industry subgroup. ABS catalogue 1350.0, Australian Economic Indicators, Aug 2009, table 13500DO001_200907.

Thus, the importance of the grocery industry and channel has increased in the last decade and its growth has outpaced that of **both** GDP and the overall retail sector in the second half of the decade.

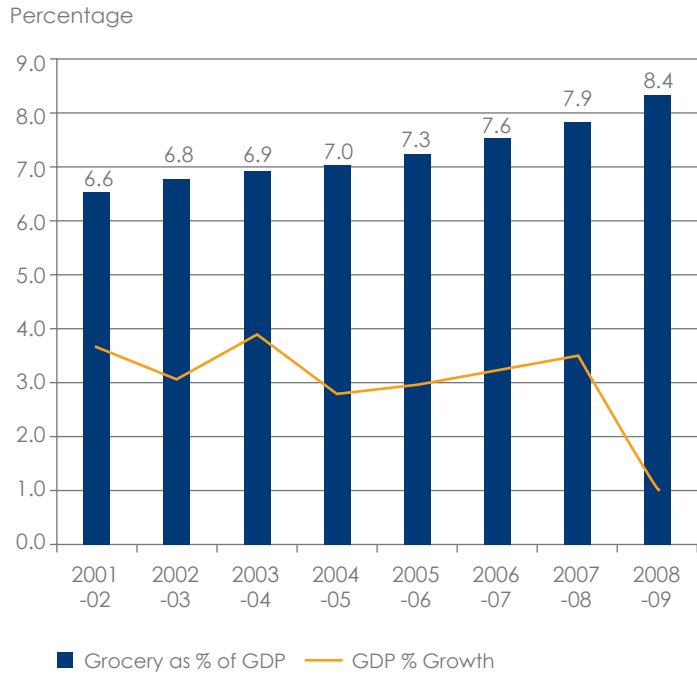
Similar trends are observed in the wider retail sector, which similarly has outpaced the GDP growth in Australia and is now a cornerstone of the Australian economy.

It has grown 62 per cent over the 2000-2009 period (note that this is slightly slower than the food centric grocery sector at 70 per cent growth in the same period). It also registered \$230 billion in turnover in 2008-2009 financial year. The retail sector as a whole, now forms over 20 per cent of the total Australian economy.

Australian retail has a more stable growth pattern when compared to other countries. The patterns are much less “peaky” than those of other countries, such as France, Canada or Japan that oscillated between growth and stagnation. This may be indicative of reduced competition. However, the retail industry provides a steady growth “engine room” to the Australian economy and the other related industries that depend on it.

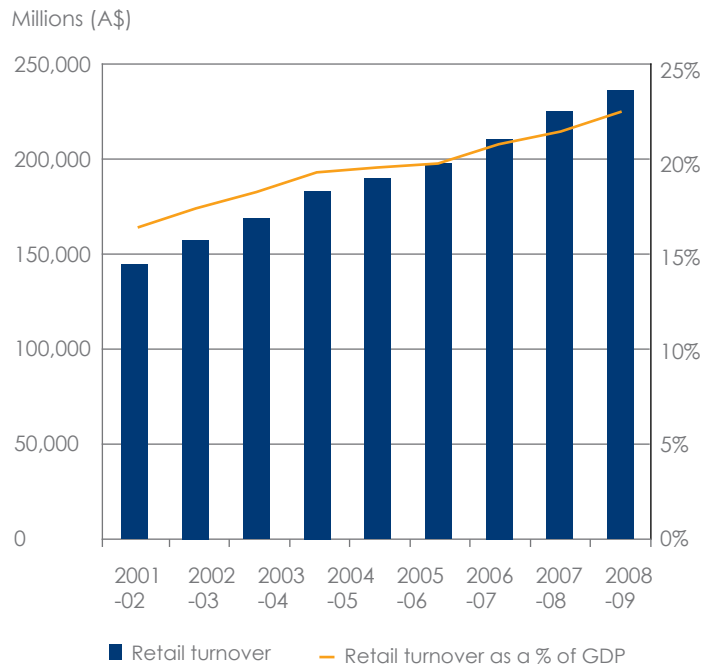


Fig 14. Grocery Retail Share in GDP (2000-2009)



Sources: ABS catalogue 8501.0 'Retail Trade, Australia', table 11, Retail Turnover, state by industry subgroup. ABS catalogue 1350.0, Australian Economic Indicators, Aug 2009, table 13500DO001_200907.

Fig 15. Retail Turnover Trend (2000-2009)



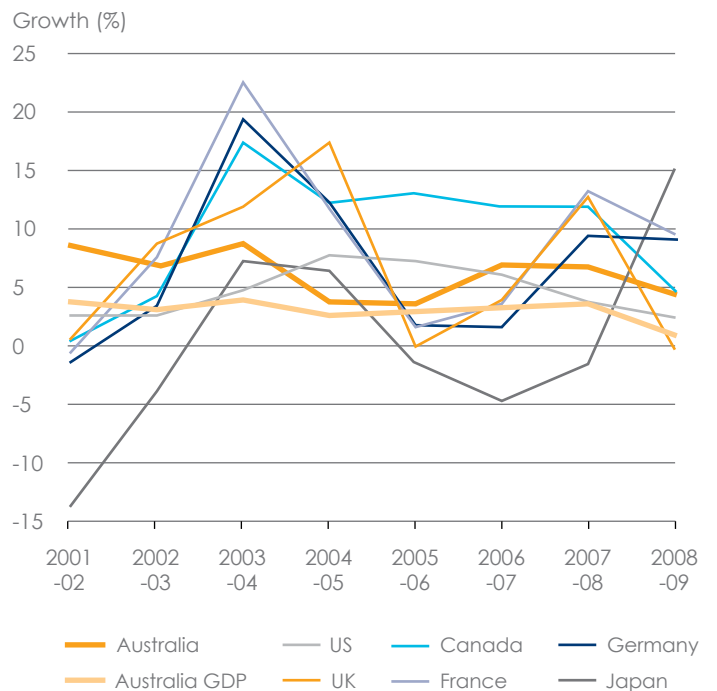
Source: ABS catalogue 8501.0 'Retail Trade, Australia'. Table 11. Retail Turnover, state by industry subgroup.

Fig 16. Retail Turnover Growth (2000-2009)



Source: ABS catalogue 8501.0 'Retail Trade, Australia'. Table 11. Retail Turnover, state by industry subgroup. ABS catalogue 1350.0, Australian Economic Indicators, Aug 2009, table 13500DO001_200907.

Fig 17. Retail Growth (per cent): Global Comparison



Sources: ABS catalogue 8501.0 'Retail Trade, Australia'. Table 11. Retail Turnover, state by industry subgroup. ABS catalogue 1350.0, Australian Economic Indicators, Aug 2009, table 13500DO001_200907. Planet Retail.

3.1 An employment perspective on the retail, grocery and food industries

The retail industry is the single biggest employer in the Australian Economy – with over 1.5 million Australians being part of the industry. The grocery sector on its own is in the top ten of the usual industry classifications and employs 411,000 people.

An additional interesting perspective relates to the combined workforce that works in the grocery sector as well as the upstream manufacturing and primary production sectors. These form the “paddock to plate” value chain, which employs just over 912,000 Australians and ranks as the sixth biggest employer of its own accord.

This is the sector that is, as a whole, being affected by the trends that we have observed in the first part of this report. These are the trends that are currently indicating that its sustainability is at risk.

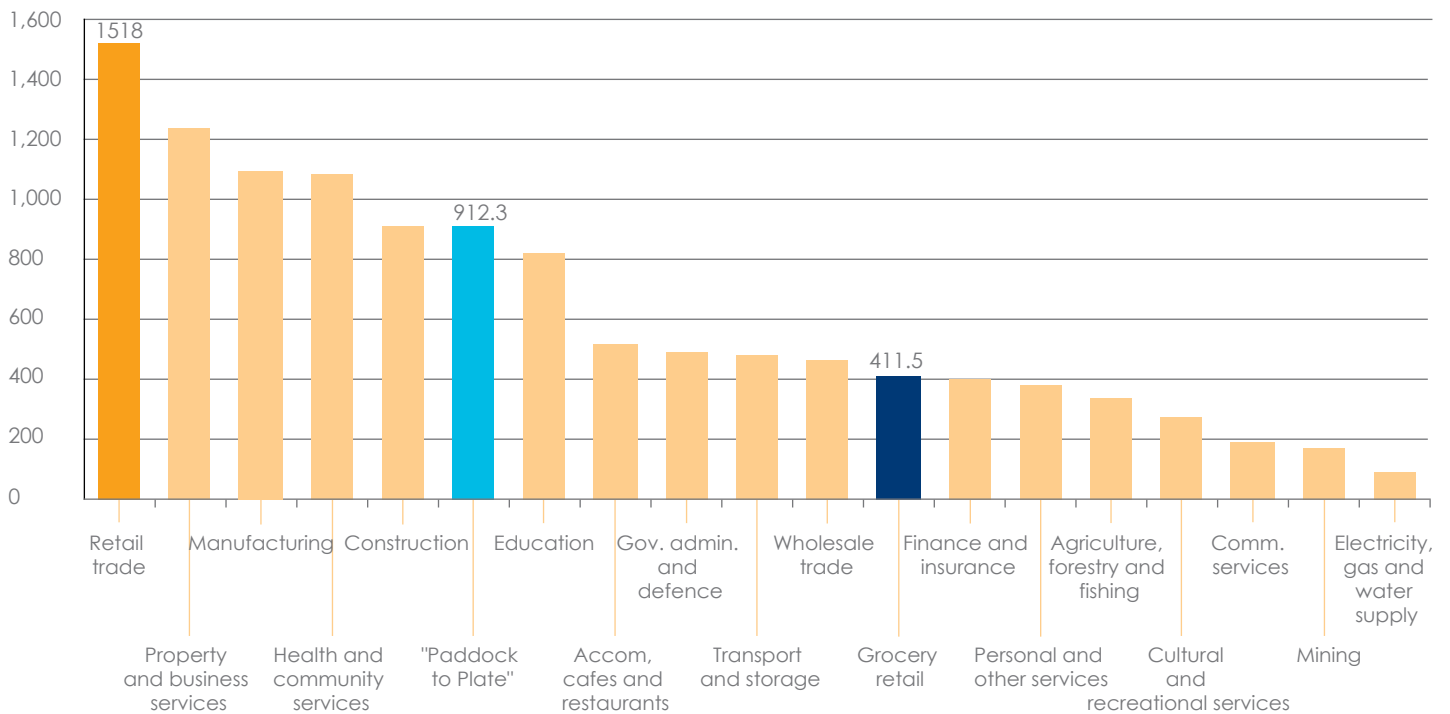
The grocery component of this value chain has shown healthy employment trends between 2000-2008:

- Overall employment grew 33 per cent , from 300,000 to 411,000 people
- Full time employed grew 25 per cent- from 131,700 to 164,000 people
- Grocery increased its share of total retail employment to 27 per cent
- Grocery increased its share of total employment to five per cent.

As a side note - Woolworths and Coles, the two key retail grocery chains employ 53 per cent of the grocery workforce vs. their market share of 79 per cent.

Fig 18. Total Employment by industry in 2008

Persons employed ('000)



Source: ABS catalogue 6105.0 'Australian Labour market Statistics'.

Fig 20. Grocery Retail Employment Growth (2000-2009)

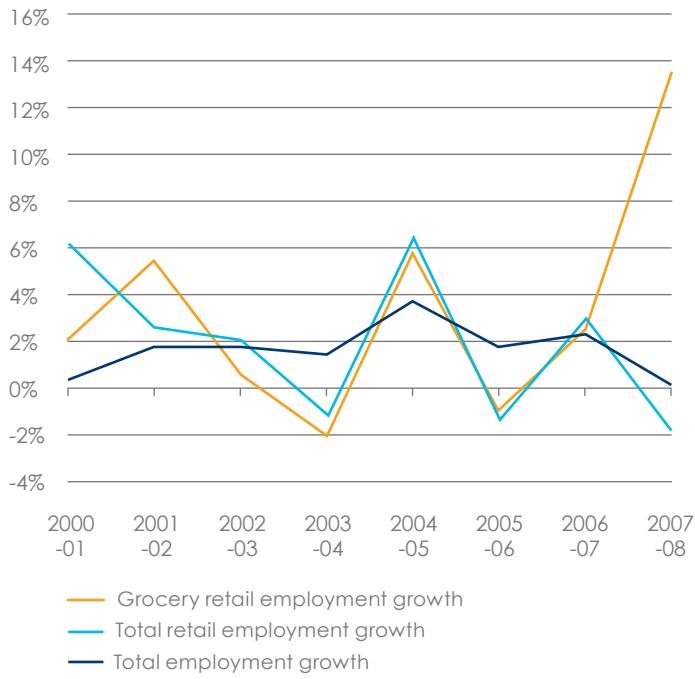
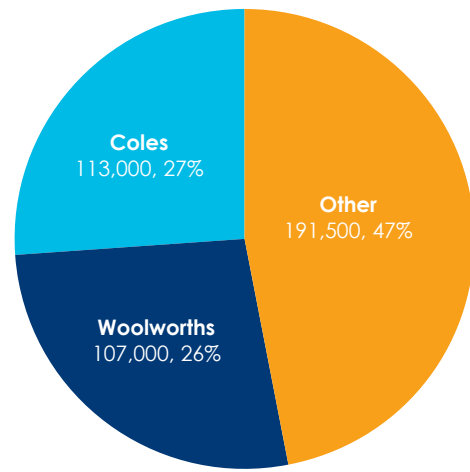


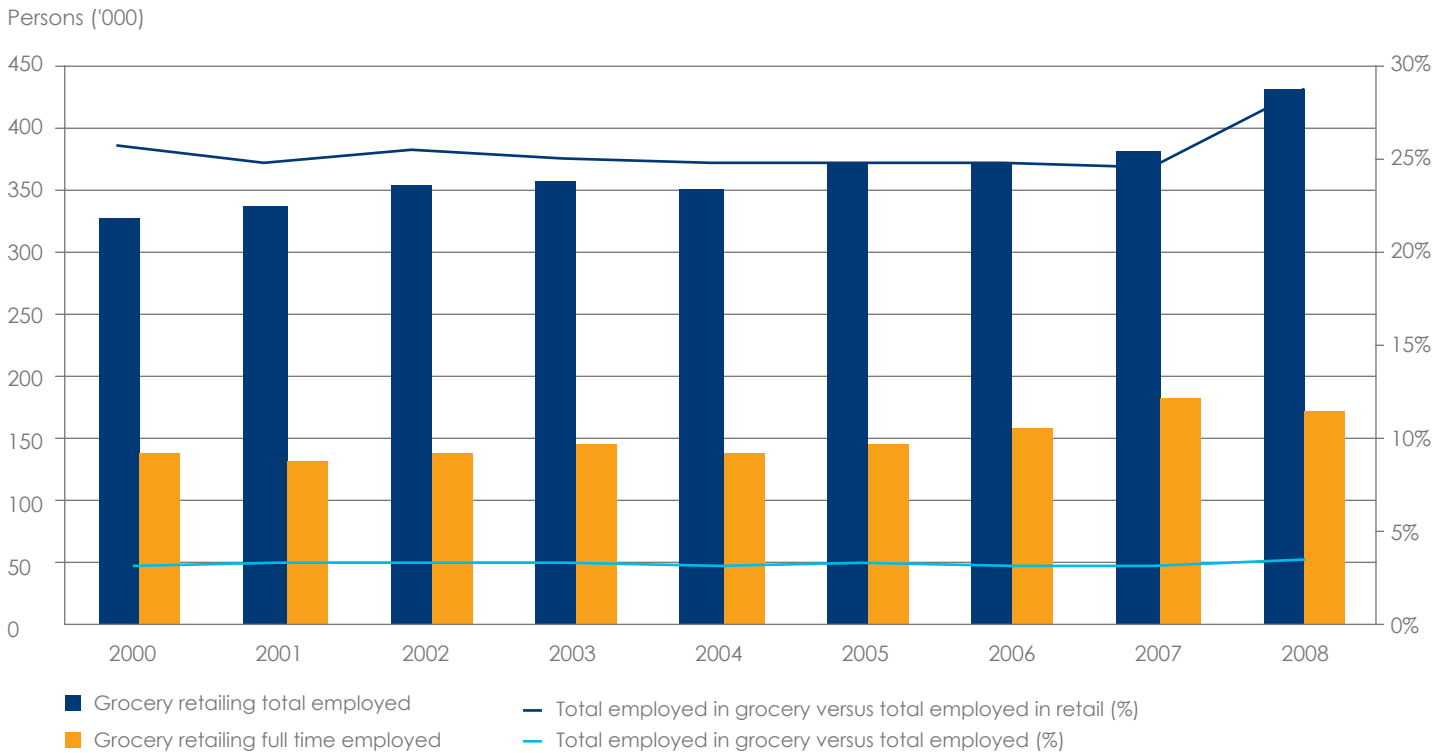
Fig 21. Grocery Retail Employment Profile (2008-09)



Sources: Coles and Woolworths annual reports 2009, ABS catalogue 6105.0 'Australian Labour market Statistics' table 4. 'other' category includes employed persons in independents supermarkets and discounters, convenience & forecourts retailers, other specialized grocery retailers.

Source: ABS catalogue 6105.0 'Australian Labour market Statistics' table 4.

Fig 19. Grocery Retail Employment Trend



Source: ABS catalogue 6105.0 'Australian Labour market Statistics' table 4.

3.2 Retail and grocery sectors – cross industry perspectives

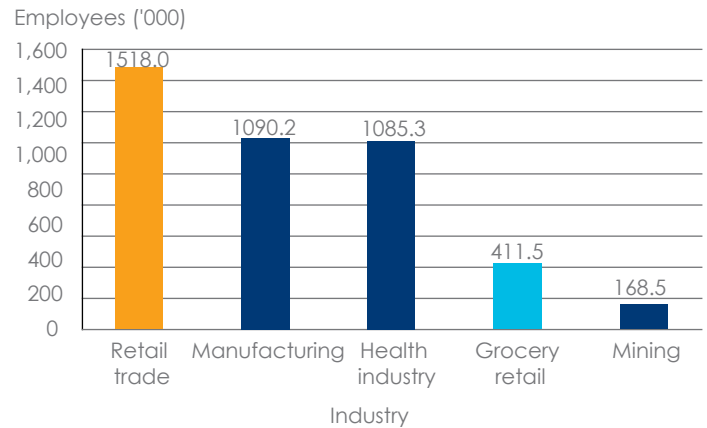
It is also relevant to provide some additional cross-industry perspective to the nature of the retail and grocery sectors.

Overall, retail is the largest employer in the Australian economy. Grocery as a sector of retail employs more people than the mining industry.

Taking the comparisons further than employment and in the context of turnover figures, although trailing the combined manufacturing sector, retail has a turnover nearly twice that of the mining sector.

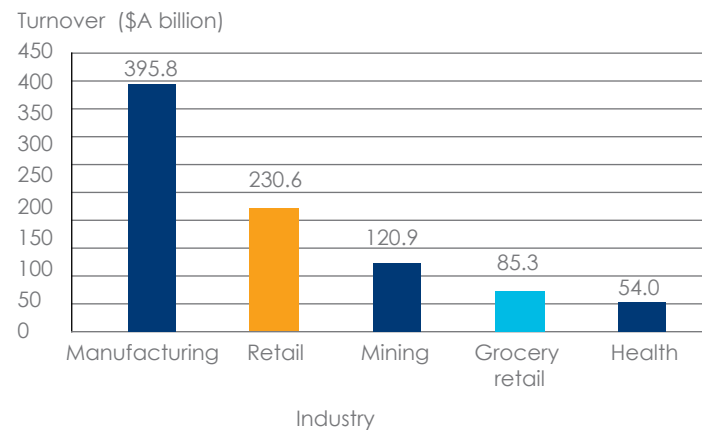
Lastly, with regard to the number of businesses, retail has twice as many as the manufacturing sector – signaling higher level of dispersal, although not to the same degree as the construction sector (which is populated by a large number of sole-trader type businesses), reflecting the need for grocery retail outlets to service widely distributed local communities.

Fig 22. Employment Industry Comparison, 2008



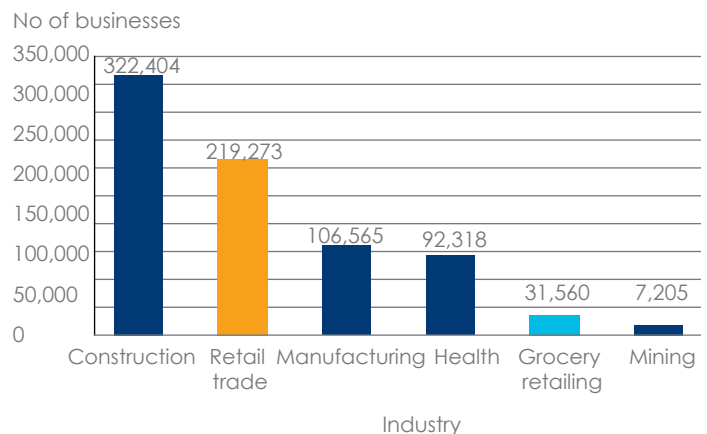
Source: ABS catalogue 6105.0 'Australian Labour market Statistics' table 4.

Fig 23. Industry Turnover Comparison 2008



Source: ABS: 81550DO001_200708 Australian Industry, 2007 -08 (Additional Data Cubes) Table 1

Fig 24. Industry Comparison: Number of Businesses (2007)



Sources: ABS Businesses by Industry Division 2003-2007 and catalogue 8165.0 counts of Australian businesses June 2003 to June 2007.

3.3 Grocery sector - size, shares and stores context

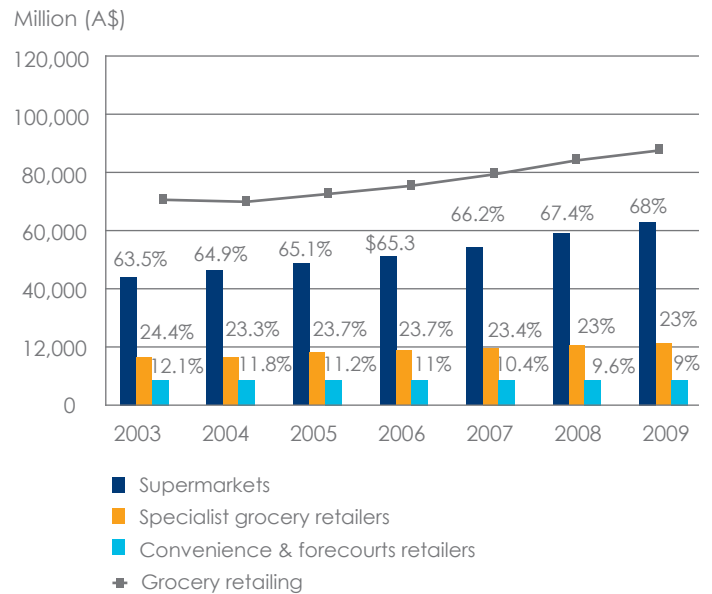
Looking at the trends across the key channels in the grocery sector provides additional perspective as to the dynamics of the industry. There, the patterns vary across the three key channels of: supermarkets, specialist grocery retailers and convenience and forecourt retailers².

Across these key channels in grocery, supermarkets have been the key growth drivers for this sector, with their share of the sector rising from 63.5 per cent to 68 per cent (from \$43 billion to \$62 billion in the period 2003 to 2009, a total of 43 per cent growth).

Smaller operators, such as specialist grocery retailers and convenience and forecourt retailers registered slower or patchy growth rates.

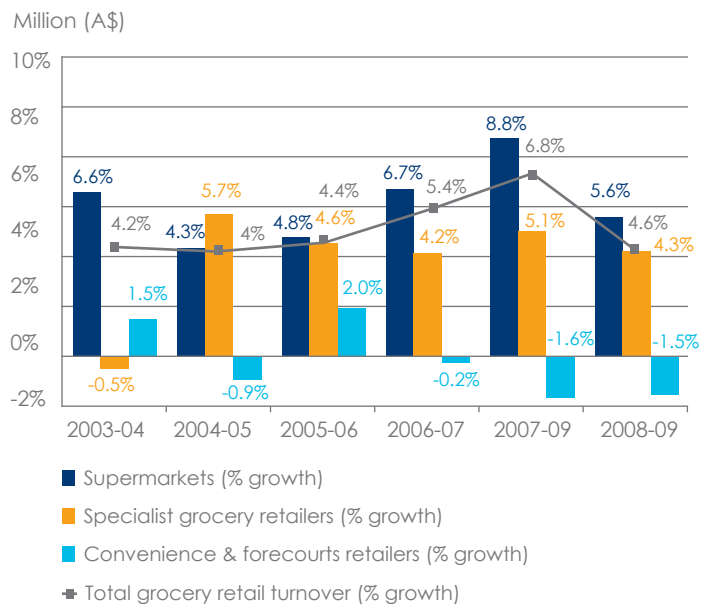
The convenience sector has in fact shrunk in importance and registered negative growth in the last three years of the decade, coinciding with the overall economic slowdown and increased competitive pressures from other Grocery channels.

Fig 25. Turnover by Grocery Channel (2000-2009)



Source: Euromonitor International: Retailing in Australia 2009.

Fig 26. Turnover Growth by Grocery Retail Channel (2000-2009)



Source: Euromonitor International: Retailing in Australia 2009.

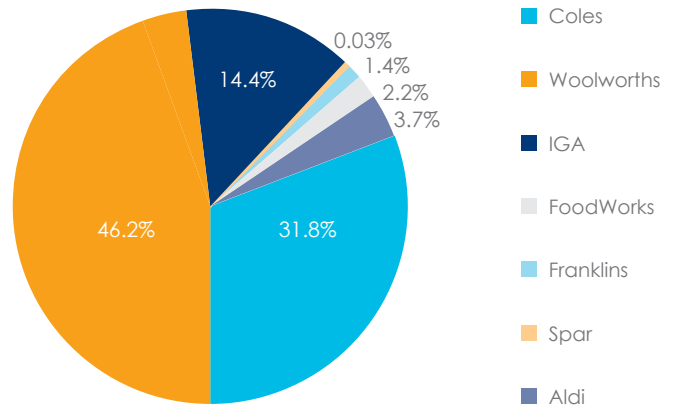
2. "Supermarket outlet" indicates the 'majors' (Coles & Woolworths), and the 'independents' (IGA, Foodland, FoodWorks, Franklins and other bannered stores and limited assortment stores such as Aldi and SPAR). According to Euromonitor, these are retail outlets selling groceries with a selling space of between 400 and 2,500 square metres. "Specialist grocery retailers" indicates the retail outlets specialising in the sale of mainly one category of food, drinks stores and tobacconists and includes bakers (bread and flour confectionery), butchers (meat and meat products), fishmongers (fish and seafood), greengrocers (fruit and vegetables), drinks stores (alcoholic and non-alcoholic drinks), tobacconists (tobacco products and smokers' accessories), cheesemongers, chocolatiers and other single food categories (Euromonitor). The convenience and forecourt retailers category is an aggregation of convenience stores, independent small grocers and forecourt retailers (chained and independent). (Euromonitor).

Market share statistics and trends across the grocery channels and even within the key supermarket channel, are hard to stabilize, due to different methodologies and data coverage across different sources. As such, the focus is on range of market share as opposed to exact measures.

Market share rankings in the supermarket sectors are quite consistent, with Woolworths, Coles and IGA being the order of the major players. Combined market share of Woolworths and Coles ranges between 77 and 80.4 per cent. Shares for IGA banners range from 11.3 per cent (various publication and estimates from Metcash) to 14.4 per cent (Euromonitor).

The market share discussion in the supermarket sector gives rise to the much-discussed level of industry concentration in this sector. Indeed, Australia has the most concentrated supermarket sectors in the world - whether one takes the top two or top three or top five players into account in the analysis.

Fig 27. Market Shares: Supermarkets (2009)



Source: Euromonitor, retailing in Australia 2009.

Fig 28. 2009 Turnover by supermarkets players (incl. Liquor sales)

	Turnover (\$ billion)		Cumul		Market share	
	incl. Liquor sales	excl. Liquor sales	incl. Liquor sales	excl. Liquor sales	incl. Liquor sales	excl. Liquor sales
Woolworths	\$32.8	\$27.6	\$32.8	\$27.6	47.4 %	45.6 %
Coles	\$22.5	\$20.1	\$55.3	\$47.7	32.7 %	33.2 %
IGA retail	\$8.2	\$7.7	\$63.5	\$55.4	11.9 %	12.7 %
FoodWorks	\$1.7	\$1.6	\$65.2	\$57.0	2.5 %	2.6 %
Franklins	\$0.9	\$0.9	\$66.1	\$57.9	1.3 %	1.4 %
Aldi	\$2.3	\$2.3	\$68.4	\$60.2	3.3 %	3.8 %
Spar	\$0.4	\$0.4	\$68.8	\$60.6	0.6 %	0.7 %
Total	\$68.8	\$60.6				

Sources: Company reports 2009, Euromonitor and other publications.. Convenience & forecourts retailers and specialist grocery retailers are excluded.

Fig 29. Grocery retailing market shares – country comparison

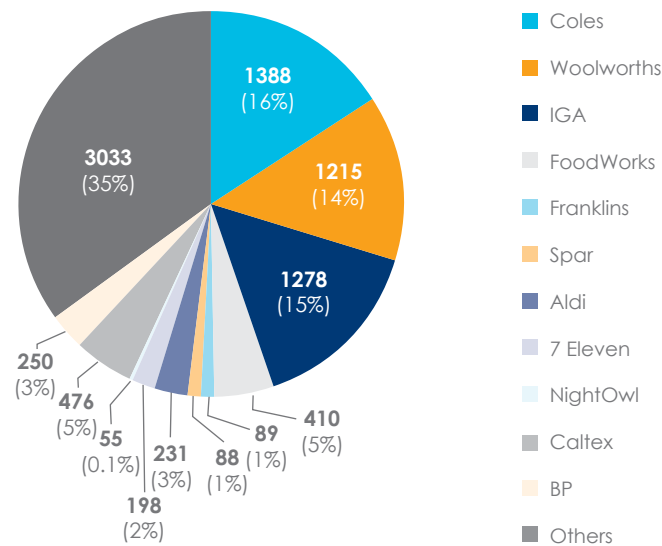
Country	Market share			Major players
	Top 2	No 3,4,5	Top 5	
Australia	79.6 %	18 %	97 %	Woolworths, Coles, IGA, Foodworks, Franklins
UK	48 %	35.5 %	83.5 %	Tesco, Asda, Sainsbury, Morrisons, Co-op Group
USA	20 %	22 %	42 %	Walmart, Kroger, Target, Walgreens, Costco

Source: Euromonitor and Planet Retail.

There has been continual dialogue and debate as to the impacts that such industry structure may have on the wider industry and the "paddock to plate" value chain. The facts that we are facing state that, since the mid 1970's, Coles and Woolworths have consistently increased their market shares, going from a combined 35 per cent in 1975 to 79 per cent combined in 2009 and only recently levelling out. Australia has become the most concentrated grocery market in the world. When compared to other countries, Australia is the only market where two players have close to 80 per cent of the market.

We will now turn to provide additional context to the grocery sector in regards to the store numbers. Across all the grocery retail stores, the single largest sector in regards to store numbers - with over 3000 stores is the "Other" category which relates to small independent grocery retailers, in the convenience & forecourt retailing sector.

Fig 31. Grocery Retail Number of Stores (2009)



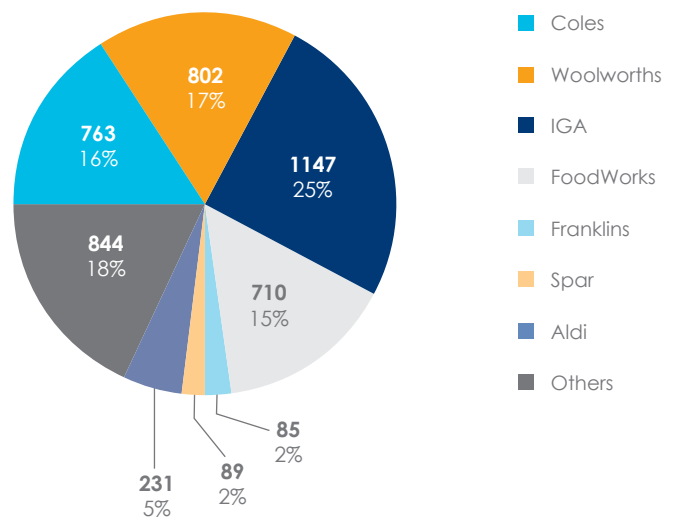
Source: Euromonitor, Retailing in Australia 2009. Companies annual reports 2009 also includes Bi-Lo and Coles Express. IGA includes IGA Express. Spar includes Spar Express.

With regard to the number of stores across the key banners and groups, Woolworths, Coles and IGA take the top three spots.

When the supermarkets are broken out of the total grocery numbers, IGA has around 25 per cent of store numbers, followed by Woolworths at 17 per cent and Coles at 16 per cent. FoodWorks, ALDI, SPAR and Franklins complete the rankings for supermarkets.

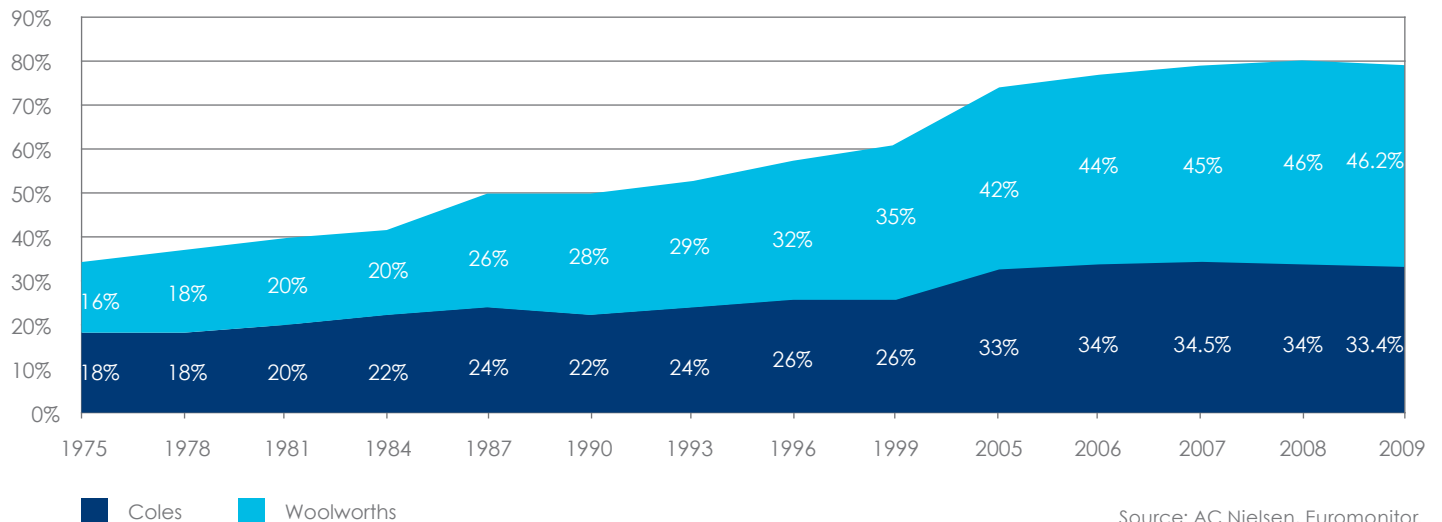
Caution should be taken when comparing store numbers, especially stores in a metropolitan area versus stores in regional Australia (IGA, FoodWorks). Independents have 40 per cent of the grocery stores in Australia overall with only 20 per cent of the market, due to the fact that they serve many small regional and rural communities, with stores smaller than those operated by the big chains in major urban centres.

Fig 32. Supermarkets Store Numbers (2009)



Source: Euromonitor, Retailing in Australia, 2009, companies annual reports 2009.

Fig 30. Growth in Market Share of Woolworths & Coles (1975-2009)



Source: AC Nielsen, Euromonitor.



4. Australian food and grocery industry & "paddock to plate" context and structure

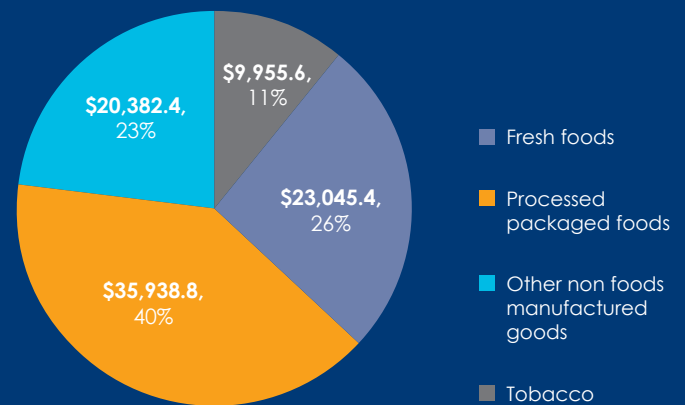
The impact of the food industry stretches beyond the retail end of the value chain and encompasses the "paddock to plate" eco-system of businesses that grow, process, reprocess and then sell the food in Australia and beyond. We will look at the structure and the components of this eco-system more closely in this part of the report.

We will start, however, by delving a bit deeper first into the make up of the retail side of the food story, to provide additional detail as to the nature of the mix of goods and the role of food categories at the end of the value chain. In the following pages, we set out the turnover of each grocery category and the value added at each step in the supply chain. Taken together, they account for a large part of the Australian economy.

They also reflect the purchasing choices of Australian supermarket customers on a daily and weekly basis.

When we look a typical breakdown of total grocery figures across the key departments - fresh foods, processed and packaged foods, other non-foods and manufactured goods and tobacco - it becomes apparent that food still is the major component of the total value of goods sold through this channel – making up 66 per cent of the total.

Fig 33. Grocery Retail Departments Turnover (\$ million) 2008



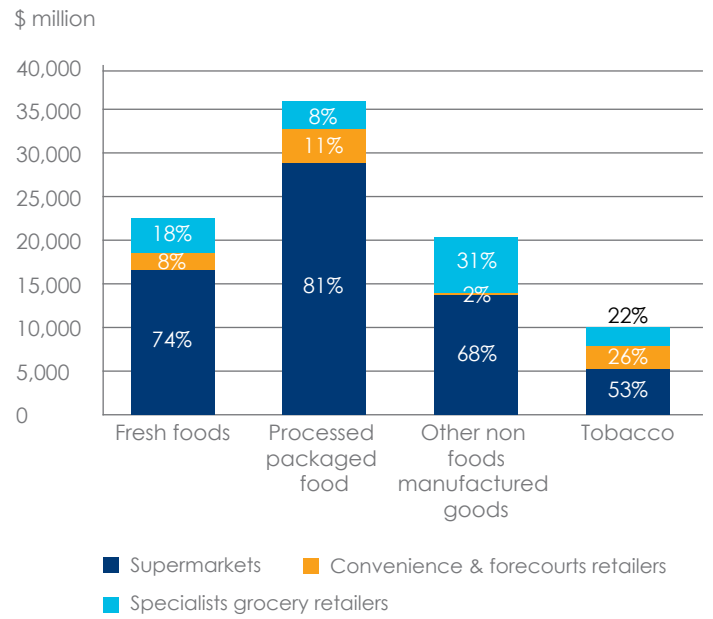
Sources: consolidated data from various sources; Euromonitor Data, ABS, and other official statistics from industry associations.

Processed packaged goods (40 per cent) and fresh foods (26 per cent) - that is food-based departments - are the two biggest contributors to overall sales value. In terms of categories, drinks and confectionary (16.6 per cent), general merchandise (11.7 per cent) and tobacco (11.1 per cent) are the top three key value categories. [Fig. 34]

It can also be observed that the goods have different sales patterns across channels, reflecting shoppers' preferences and shopping occasions and missions:

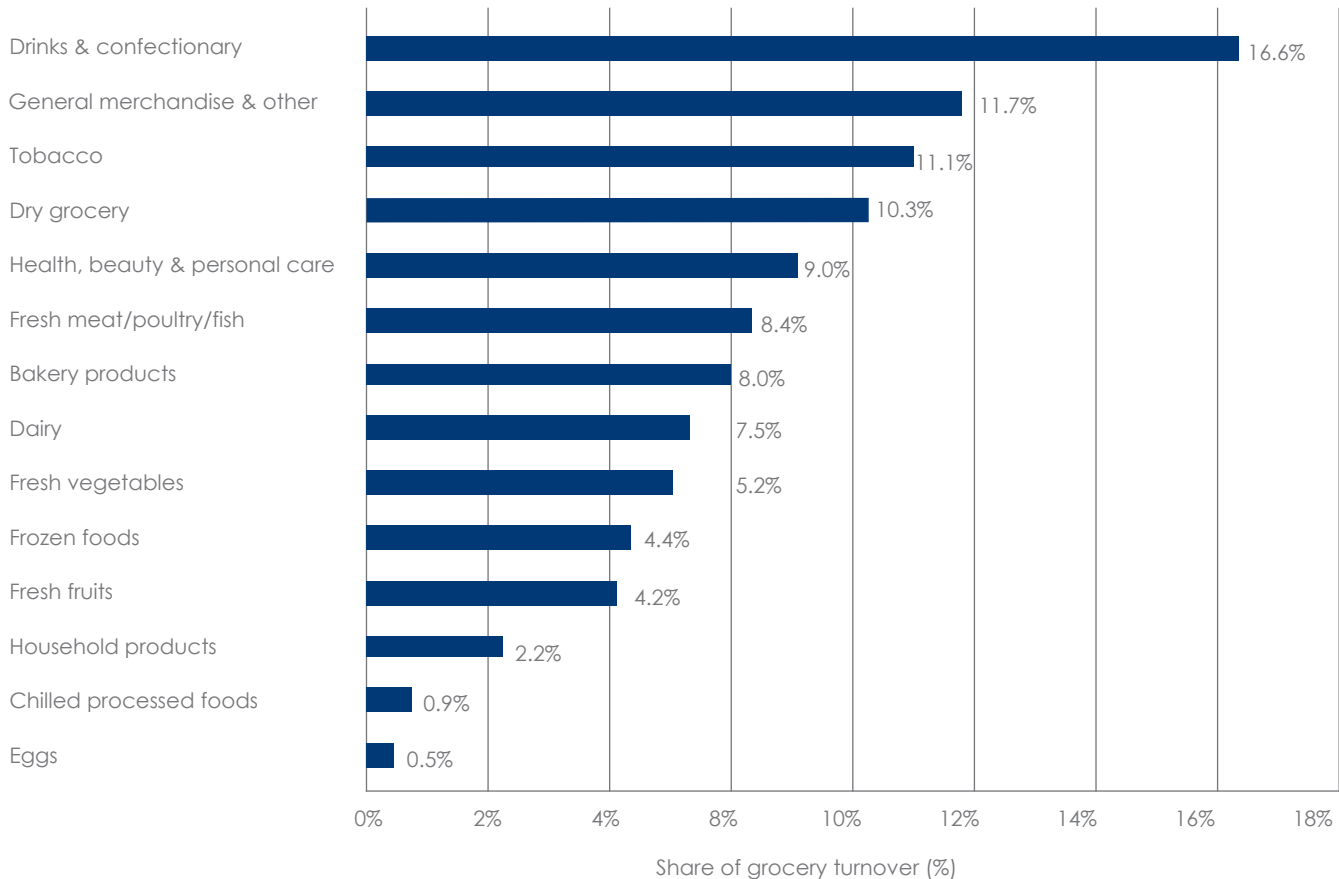
- Supermarkets dominate the processed packaged goods and non foods areas
- Specialist grocery retailers are still key for fresh foods
- Convenience and forecourt retailers play a key part for tobacco. [Fig 35]

Fig 35. Grocery Retail Departments Turnover (\$ million) by Grocery Channel (2008)



Sources: consolidated data from various sources: Euromonitor Data, ABS, and other official statistics from industry associations.

Fig 34. Grocery Retail Departments Turnover (\$ million) 2008

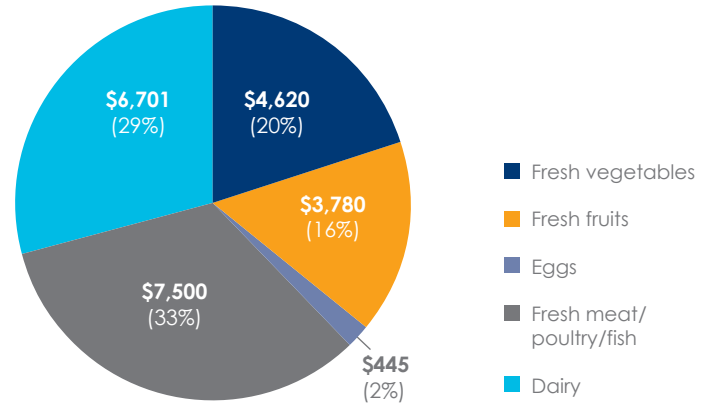


Sources: consolidated data from various sources: Euromonitor Data, ABS, and other official statistics from industry associations.

Looking at the break down of the figure further we can profile the relative importance of specific categories within each of the departments:

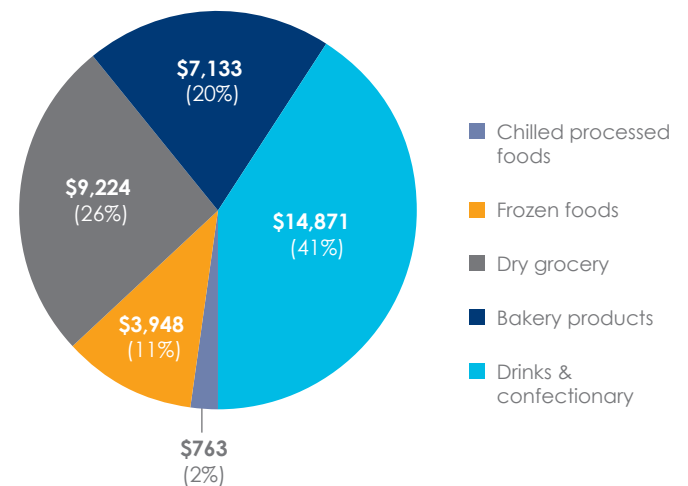
- Within fresh foods – fresh meat/poultry/fish is the key component (33 per cent), followed by dairy (29 per cent) and fresh vegetables (20 per cent). [Fig 36]
- For processed packaged goods – drinks and confectionary makes up 41 per cent of the value, followed by dry grocery (26 per cent) and packaged bakery (20 per cent). [Fig. 37]
- For non foods – general merchandise dominates at 51 per cent followed by Health and Beauty at 39 per cent. [Fig. 38]

Fig 36. Fresh Foods Categories Turnover (\$ million) 2008



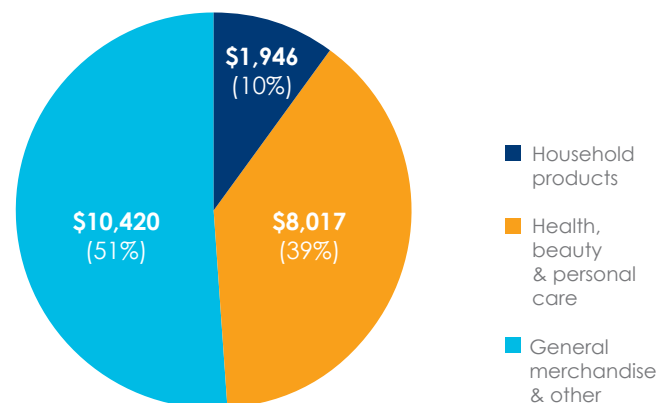
Sources: consolidated data from various sources: Euromonitor Data, ABS, IBIS (fruit & vegetable retailing in Australia 2009 and 'meat, fish & poultry retailing in Australia') and other official statistics from industry associations.

Fig 37. Processed Packaged Foods Categories Turnover (\$ Million) 2008



Sources: consolidated data from various sources: Euromonitor Data, ABS, and other official statistics from industry associations.

Fig 38. Non Food Manufactured Goods Categories Turnover (\$ Million) 2008



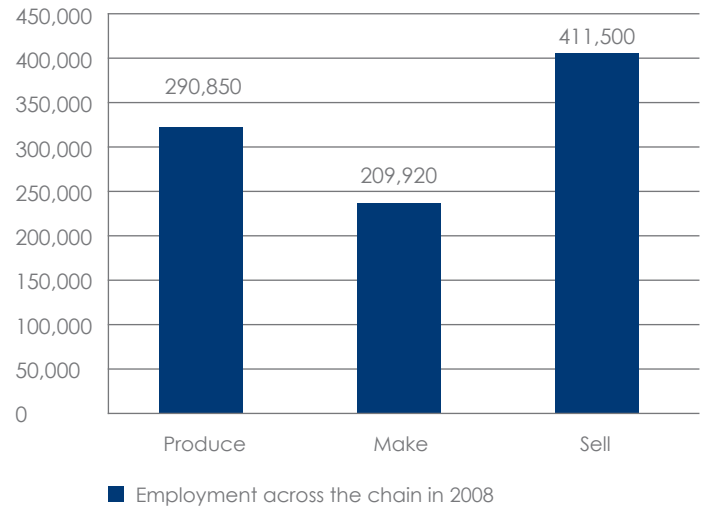
Sources: consolidated data from various sources: Euromonitor Data, ABS, and other official statistics from industry associations.

The data and analysis presented above profiles the Australian retail end of the “paddock to plate” grocery industry value chain, one that is much bigger and wider in regard to its impact on the Australian economy than grocery retail on its own.

The contribution of the value-add component to the economy, across the primary, manufacturing and retail steps in the value chain, is worth \$126 billion – 61 per cent of the total turn-over value. These figures make the grocery “paddock to plate” value chain eco-system a mission critical part of the Australian economy.

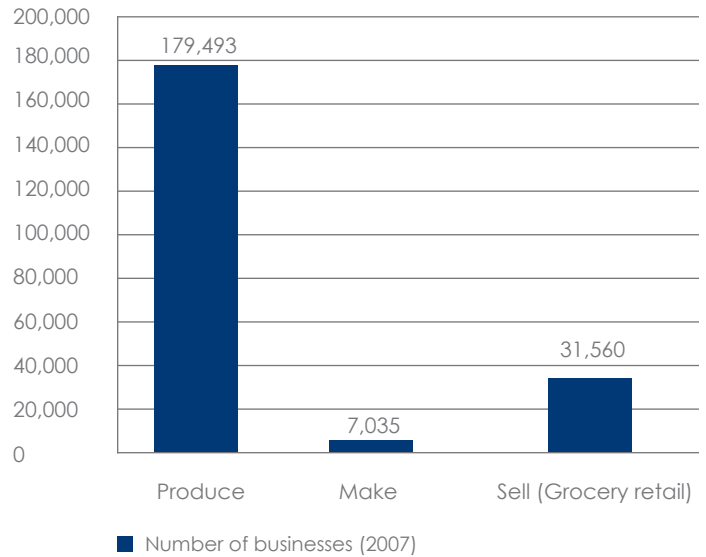
As hinted in the section where we explored the employment profiles of the key industries in Australia – the “paddock to plate” grocery value chain employs more than 912,000 Australians, which is well in excess of the 411,000 that are employed by the retail portion of the value chain. Overall, the grocery “paddock to plate” value chain is worth approximately \$209 billion to the Australian economy in turn-over - close to 20 per cent of the total economy. It is made up of more than 218,000 businesses. It contributed around \$25 billion in export income to the Australian economy in 2008 – 11.5 per cent of total exports for Australia.

Fig 39. Employment across the Chain in 2008



Source: ABS catalogue 6105.0 'Australian Labour market statistics' table 4.

Fig 40. Number of Businesses (2007)



Source: ABS catalogue 8165.0 counts of Australian businesses June 2003 to June 2007.

Fig 41. Exports & Imports overview 2008 (A\$ billion)



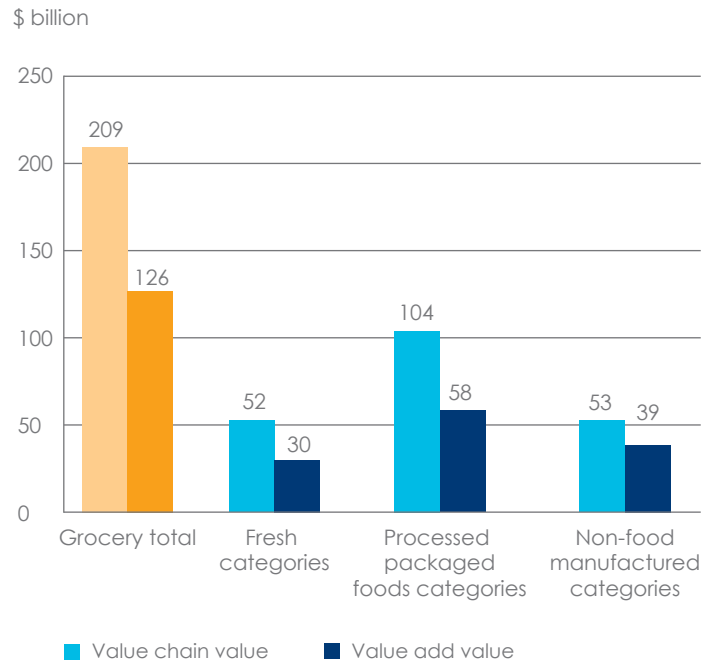
Source: ABARE, Australian Food Statistics 2008.

At the same time, the current trends of lowered production put into question the industry's ability to continue to generate added value to Australian GDP, and the feasibility of effectively addressing current consumption demands from Australian consumers.

Looking at the values for the grocery "paddock to plate" value chain across its key product categories provides additional insights into the structure of this industry in Australia:

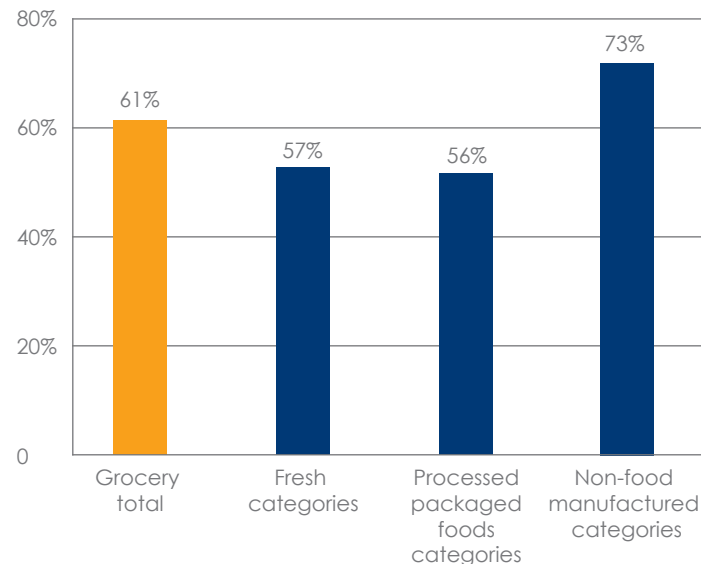
- Fresh categories make up 25 per cent of total value chain value at \$52 billion, and contribute \$30 billion in value-add creation for the value chain. This is a ratio of 57 per cent for value add component to the overall value.
- Processed packaged foods make up 50 per cent of total value chain value and represent the largest component of the grocery value chain with \$104 billion. Processed packaged goods contribute with \$58 billion in value-add creation for the value chain. This is a ratio of 56 per cent for the value added component to the overall value.
- Non food categories make up 25 per cent of total value chain with \$53 billion, and with \$39 billion in value-add. This is a ratio of 73 per cent for the value add component to the overall value – the highest ratio across the three areas.

Fig 42. Australia - "Paddock to Plate" value chain values in \$ Billion



Sources: ABS, ABARE, Euromonitor (retailing in Australia, Packaged Foods Australia, soft drinks Australia, chilled processed foods Australia Pet food/care Australia, cosmetics & toiletries Australia, households care Australia, consumer health Australia), Industry associations, Australian Food Statistics Report 2008, AFGC state of the industry report 2009, IBIS (supermarkets and other grocery stores in Australia).

Fig 43. Australia - "Paddock to Plate - Comparative Rates of Value add components



Sources: ABS, ABARE, Euromonitor (retailing in Australia, Packaged Foods Australia, soft drinks Australia, chilled processed foods Australia Pet food/care Australia, cosmetics & toiletries Australia, households care Australia, consumer health Australia), Industry associations, Australian Food Statistics Report 2008, AFGC state of the industry report 2009, IBIS (supermarkets and other grocery stores in Australia).

The analysis that led to these consolidated figures involved breaking down the overall "paddock to plate" grocery value chain into two parts:

UPSTREAM

This covered primary and secondary production of the grocery items, that is the PRODUCE and MAKE steps.

- In addition the analysis broke down the steps further to address the exports and imports flow that form part of the process
- Lastly, all of these were profiled across the key 15 product categories found in a supermarket and that make up the overall grocery numbers.

DOWNSTREAM

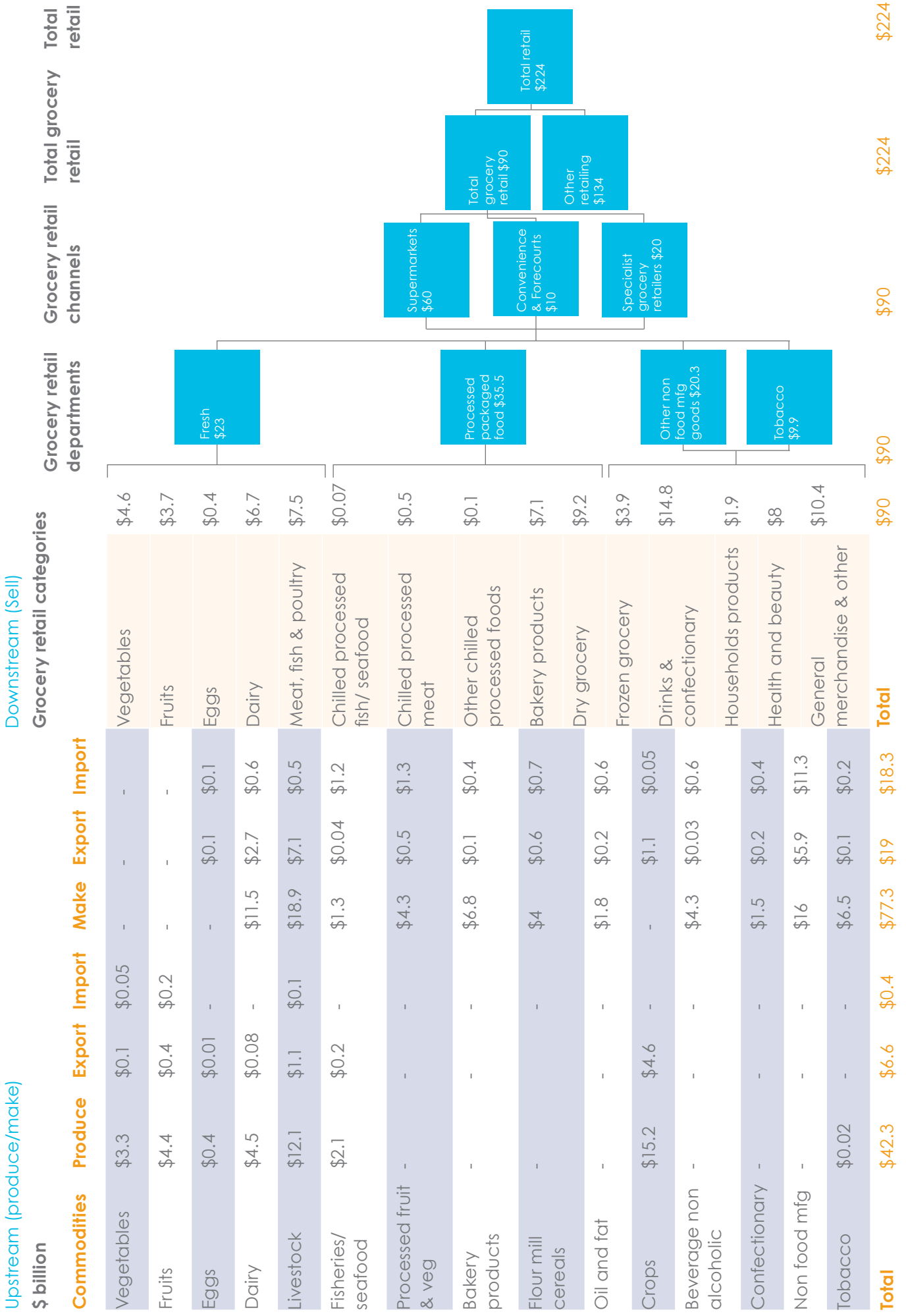
This covered the SELL component of the value chain, that is the retail side of the industry.

- The 15 categories were then consolidated to four grocery departments. These were then analysed as to how they are sold through the key retail grocery channels and also as to what portion they make up of the total retail trade value in Australia.

This analysis involved significant aggregation of multiple data sources. This process is outlined in the Appendix to this report.



Fig 44. Australia - "Paddock to Plate" - Comparative Rates of Value add components



4.1 The "paddock to plate" profiles and value add analysis

The dynamics and profiles of the overall grocery "paddock to plate" value chain, as well as of the key departments, provide additional insights as to nature of the industry.

When one links the structure seen here with some of the trends that were outlined in the initial part of the report, **it is evident that "Produce" and "Make" domestic value add components are at risk in view of the current production trends and their displacement by imports** to make up the consumption gap. Currently exports at both Produce and Make parts of the value chain outweigh the imports – this may no longer be the case if the current trends continue. This is part of the "sustainability" dilemma.

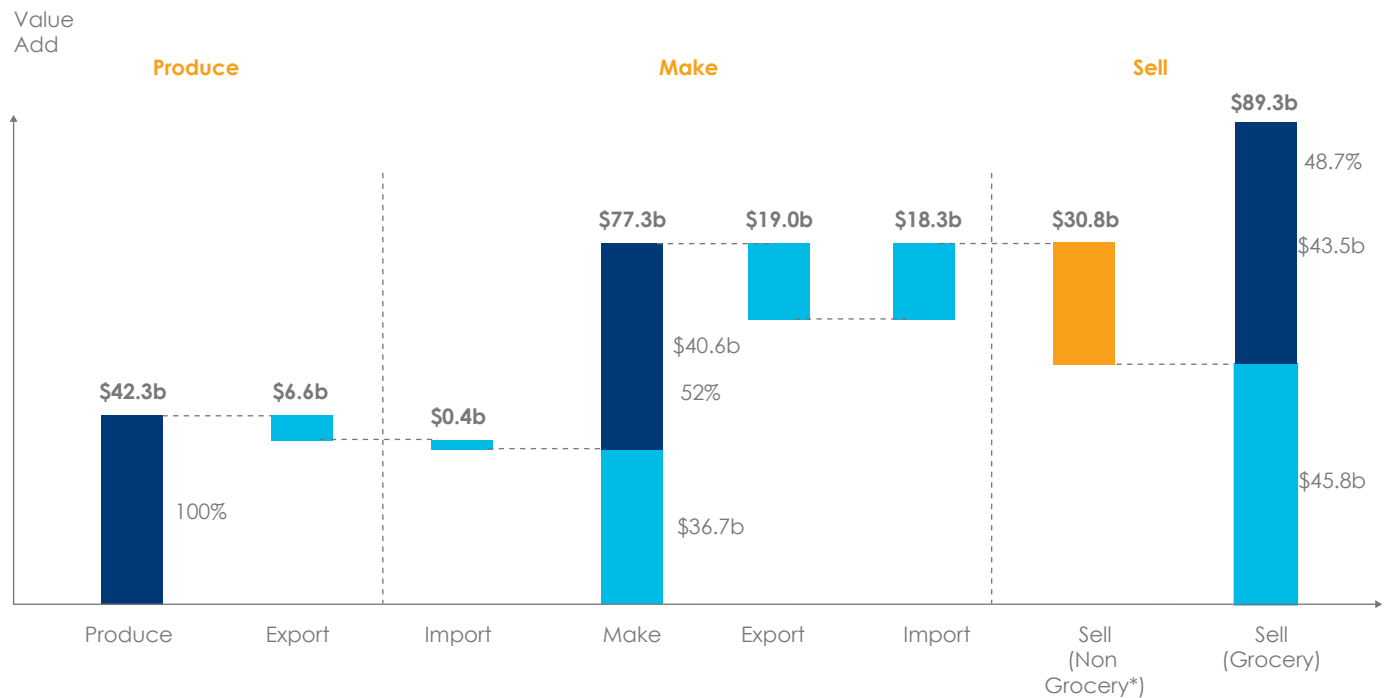
This implies that the overall contribution of the food and grocery value chain – our "paddock to plate" – is being put under pressure due to the current lack of holistic response by the industry to adjust its

structure and outputs to address the current and emerging consumption patterns.

There is potential benefit for industry and government in exploring the underlying drivers of this dynamic. There is also a dilemma - how should we develop a structured set of strategies that will allow the whole industry to move forwards in tune with market trends and demand and supply cycles?

The dilemma faced is not one between "growth" or "no growth" in the food and grocery industry - growth is a given as the population increases - but between having a high quality, safe and secure domestic food supply or allowing it to be replaced in whole or in significant part by imports. While increased imports might help contribute to variety and competition, they might also undermine the stability of the domestic supply chain used to support domestic consumption.

Figure 45. Value Add Overview



■ =Total value add: \$126.4b

*Sell(Non Grocery)=Cafe/Restaurant/Catering services/Takeaways food services/other

Sources: ABS, ABARE, Euromonitor, Industry associations, Department of Agriculture, Fisheries and Forestry, Australian Food Statistics Report 2008, AFGC state of the industry report 2009, IBIS.

The following pages set out the value added at each step in the supply chain for various sectors of the food and grocery industry. This is what is now at risk if current trends are allowed to continue.

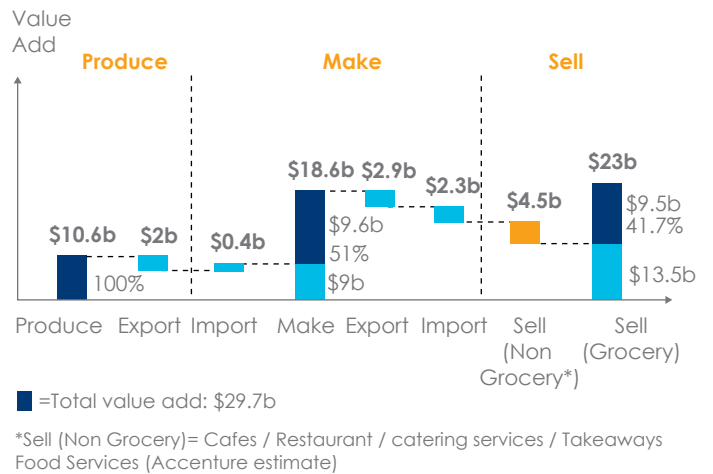
As outlined in the previous section – the overall grocery “paddock to plate” value chain is valued at \$209 billion per annum across the “Produce”, “Make” and “Sell” components. Each of these stages of this value chain adds around \$40-45 billion to the value of the goods. The percentage of value added predictably is smaller as one progresses through the value chain - from 100 per cent at “Produce”, through 52 per cent at “Make” to 48.7 per cent at “Sell”.

The fresh food value chain is worth \$ 52.2 billion across the three stages. The total value added across the value chain is \$ 29.7 billion. This makes up 23.5 per cent of the total value add for the whole grocery paddock to plate value chain.

The processed and packaged foods segment value across the overall “paddock to plate” value chain is \$104 billion. This represents the single biggest portion of the overall value chain at 49 per cent. The overall value added across the three stages of the value chain is \$58.2 billion. The processing/manufacturing stage of the value chain (make) has a 25 per cent value added whilst the retail (sell) stage has a 48 per cent value add.

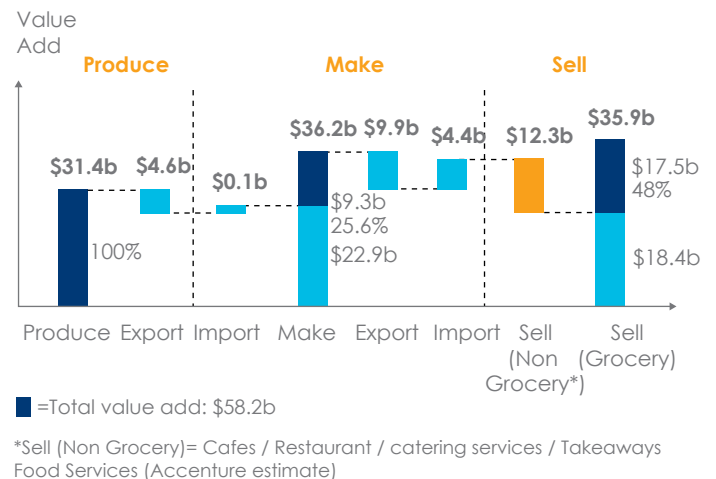
The non-food manufactured goods area of grocery, inclusive of tobacco is worth \$52.9 billion. This represents around 25 per cent of the overall value of the grocery “paddock to plate” value chain. Nearly all of the value of the sector is created at either “Make” or “Sell” levels – due to lack of primary farm food inputs into the production of “non food” items. The raw materials for production come from the resources sector. The sell component has a significant realized value add factor at 53.7 per cent - this is the highest across the three areas.

Figure 46. Value Add Overview: Fresh Foods



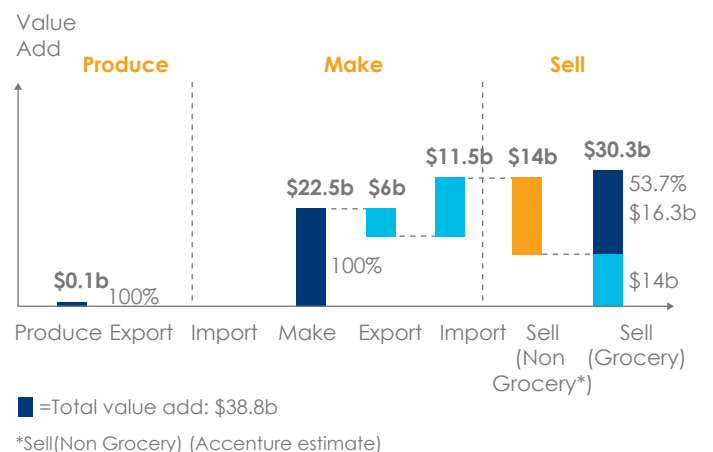
Sources: ABS, ABARE, Euromonitor, Industry associations, Department of Agriculture, Fisheries and Forestry, Australian Food Statistics Report 2008, AFGC state of the industry report 2009, IBIS.

Figure 47. Value Add Overview: Packaged Foods



Sources: ABS, ABARE, Euromonitor, Industry associations, Department of Agriculture, Fisheries and Forestry, Australian Food Statistics Report 2008, AFGC state of the industry report 2009, IBIS.

Figure 48. Value Add Overview: Non Foods



Sources: ABS, ABARE, Euromonitor, Industry associations, Department of Agriculture, Fisheries and Forestry, Australian Food Statistics Report 2008, AFGC state of the industry report 2009, IBIS.



Food production at primary level ('PRODUCE'):

- The Australian Bureau of Statistics (commodities tables)
- ABARE (Australian Bureau of Agricultural and Resource Economics)
- The Australian Food Statistics Report 2008
- Industry reports such as AMIC (Australian Meat Industry Council), Australian Eggs Corporation, Dairy Australia)

Food production at processing level ('MAKE'):

- Australian Food Statistics report 2008
- Australian Bureau of Statistics
- AFGC report 'state of the nation 2009'

Grocery retailing ('SELL'):

- Australian Bureau of statistics
- IBIS reports (2009):
 - Supermarkets and other grocery stores in Australia
 - Convenience stores in Australia
 - Fruits & vegetable retailing in Australia
 - Meat, fish and poultry retailing in Australia
- Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries, July 2008
- Euromonitor reports (2009)
 - Chilled processed food retailing in Australia
 - Tobacco retailing in Australia
 - Soft drinks retailing in Australia
 - Retailing in Australia
 - Pet food and pet care retailing in Australia
 - Packaged foods retailing in Australia
 - Household care retailing in Australia
 - Hot drinks retailing in Australia

- Disposable paper products retailing in Australia
- Cosmetics and toiletries retailing in Australia
- Consumer health retailing in Australia
- Grocery retailers annual reports:
 - Woolworths annual report 2009
 - Wesfarmers annual report 2009
 - Metcash annual report 2009
- Planet retail: grocery retailing in Australia
- NARGA report: The economic contribution of small to medium-sized grocery retailers to the Australian economy, with a particular focus on Western Australia, July 2007

For the "paddock to plate" overview, data from 2008 have been used, as data from certain categories or commodities are not available beyond 2008. Also, when available, year 2009 data have been used (e.g. market shares information, retail turnover information). Furthermore, the consulting services from the Australian Bureau of Statistics have been used for specific and customized requirements ("the ABS unpublished catalogues").

A key challenge in this exercise was to align the data from different sources. There can be some variations between sources (ABS and Euromonitor and IBIS) on the grocery retail segment due to the fact that calendar years and financial years were used at some point in time throughout the report. Overall, we estimate a variation of up to 5 per cent between ABS data for 'supermarket and grocery stores' and Euromonitor data, as an example.

5.2 Study terms and definitions

As described in appendix 1, multiple sources have been used to develop this study. For consistency and clarity purpose throughout the report, the following terms have been used:

Retail	<p>Includes Food Retailing (incl. liquor); household goods retailing; clothing & footwear retailing; Department Stores; Newspaper & Books retailing; Recreational Goods retailing; Cosmetics & Toiletry Goods retailing; cafes, restaurant & takeaways retailing; Other retailing not elsewhere classified (incl. Tobacco).</p>
Grocery Retail	<p>Retailers selling predominantly food/beverages/tobacco and other everyday groceries. This is the aggregation of supermarkets, small grocery retailers (convenience stores, independent small grocers, chained forecourt retailers, independent forecourt retailers) and food/drink/tobacco specialists.</p>
Grocery Retail Channels	<p>Grocery retail can be broken down into 3 channels:</p> <ul style="list-style-type: none"> • Supermarkets: represents the 'majors' (Coles & Woolworths), and the 'independents' (IGA, FoodWorks, Franklins, Aldi). According to Euromonitor, these are retail outlets selling groceries with a selling space of between 400 and 5000 square meters. • Convenience & forecourts retailers: aggregation of Convenience stores, Independent small grocers and Forecourt retailers (chained and independent). (Euromonitor). • The specialist grocery retailers: represent the retail outlets specialising in the sale of mainly one category of food, drinks stores and tobacconists. Includes bakers (bread and flour confectionery), butchers (meat and meat products), fishmongers (fish and seafood), greengrocers (fruit and vegetables), drinks stores (alcoholic and non-alcoholic drinks), tobacconists (tobacco products and smokers' accessories), cheese mongers, chocolatiers and other single food categories (Euromonitor).
Grocery retail departments	<p>Goods sold through grocery have been broken down into 4 departments or groups:</p> <ul style="list-style-type: none"> • Fresh Foods: includes fresh fruits, fresh vegetables, fresh fish, meat, poultry (sold 'over the counter'), dairy products, Eggs. • Processed Packaged Foods: includes chilled processed fish/meat/other; frozen foods; dry grocery; bakery products; Drinks & confectionary. • Other non food manufactured goods: Household products; health, beauty & personal care products; general merchandise & others. • Tobacco: Cigarettes, cigars, loose tobacco.

Grocery retail categories

This is the lower level within grocery retail departments:

- **Fresh Vegetables:** all vegetables
- **Fresh fruits:** all fruits
- **Eggs:** fresh eggs
- **Fresh meat, poultry fish & seafood:** beef; lamb; pork; poultry; all fish & seafood
- **Dairy products:** drinking milk, cheese, cream, butter and other milk drinking products
- **Chilled processed fish/seafood:** fresh fish & seafood presented in a plastic tray and covered by cellophane/clear wrapping and sold in self service chilled area in the store
- **Chilled processed meat:** fresh meat presented in a plastic tray and covered by cellophane/clear wrapping and sold in self service chilled area in the store. Includes beef, pork, lamb, poultry burgers, sausages, salamis, chorizos, etc.
- **Other chilled processed foods:** other chilled processed foods like ready to eat meals, chilled pizzas & pastas
- **Dry grocery:** canned meat & vegetables, sauces, cooking oil & fat, cooking needs, dried soup, dried pastas & noodles, dressings, condiments, baby foods, spreads, canned fruits, other processed foods
- **Frozen grocery:** all frozen packaged foods (pizzas, vegetables, meat, etc)
- **Bakery products:** biscuits, baked goods, cereals, bread
- **Drinks & confectionary:** non alcoholic drinks (soft drinks, teas, coffees); confectionary (cereal bars, potatoes chips, sweets, savoury snacks)
- **Household products:** laundry care, dishwashing products, surface care, bleach, toilet care, polishes, air care, insecticides
- **Health, Beauty & personal care:** baby care, bath & shower products, deodorants, hair care, colour cosmetics, men's grooming products, oral hygiene, fragrance, skin care, depilatories, suncare, analgesics, cough cold allergy remedies, digestive remedies, medicated skincare, vitamins & dietary supplements, smoking cessation aids, eye care, mouth care, other care
- **General merchandise & other:** batteries, stationery, pet food & pet care and other general merchandise

Produce

Include the value of food commodities produced at farm level. It represents the output of the agriculture industry

Make

Include the value of food commodities coming out of the manufacturing process, using agriculture commodities as inputs for further processing / transformation

Sell

Include the value of grocery products as described above at the "retail" side of the chain

5.3 Dairy industry case study

Industry context and background

The value of the dairy industry, a cornerstone component of the food value chain, was estimated at \$4.5 billion at production level and at \$11.5 billion at processing level in 2008. Australian retail turnover for dairy products was estimated at \$6.7 billion in 2008³. The dairy industry represented 11 per cent of the total Australian primary production value in 2008, and 13 per cent of the total Australian food processing industry. Approximately 55 per cent of the milk production goes to domestic use (of which 24 per cent is for drinking milk) whilst 45 per cent goes to export⁴.

The industry includes approximately 8300 dairy cattle farms employing 23000 people. The dairy processing sector employs approximately a further 20,000 people. This represents 8 per cent of persons employed in primary industry and 10 per cent of persons employed in food processing respectively in 2008.

Current trends

Consumer demand for dairy products is increasing. Consumers are demanding more dairy product variants and are more health conscious. As a result, flavored milk products and variants, such as low fat and pro biotic dairy products, have gained popularity in recent years. These have had a positive effect on innovation rates in this highly commoditised industry.

On the supply side, milk products' value growth has been affected by the removal of the dairy adjustment levy in February 2009, the introduction of private label products and by the related downward trend in retail prices. Dairy farmers are feeling the pressure from these trends from both processor and retailers, who are dealing with lower price ranges and a large switch to a commoditised private-label dairy products range. At the processing level, the dairy industry went through rationalisation and consolidation to cope with these trends. In addition, the Australian market has seen foreign companies such as Japan's Kirin making inroads through acquisitions.

Issues & challenges

Margin pressures in the production and processing parts of the value chain: The retail pricing pressures from retail grocery market concentration in the hands of two major chains have had a direct knock-on effect on prices upstream, particularly for farmers, to the point where "Some of them have found the situation unsustainable", according to Dee Margetts, a former senator for Western Australia who has researched and written on dairy industry issues.

Private label and innovation: Private label now represents 60 to 70 per cent of milk sales and represents the single biggest change in the dynamics of the category in the last decade. It has resulted in retailers exerting pressure upstream on long-term contract-based wholesale prices for producers and processors.

At a recent conference with the Dairy Industry Association of Australia and Queensland dairy farmers, farmers repeatedly heard the message from conference speakers that the recent global financial crisis had changed consumer spending patterns, resulting in a marked increase in price-focused purchases and a strong increase in market share for private label milk. In contrast, for non-commoditised products such as flavored milk and yoghurt, private label lines are not very big and demand is strongly linked to brands and new innovative products.

This is the key structural challenge for the milk industry today and it has been examined by government in the recent report from the Senate Economics References Committee (May 2010) titled "Milking it for all it's worth". It provides further evidence of the current tension in the value chain in this space:

"There has been a trend towards increased concentration among both processors and retailers of milk in Australia. This is not just a coincidence; the increase in concentration among retailers has been an important driver for the increased concentration among processors and this is likely to continue..."

3. Australian food statistics report 2008.

4. Dairy Australia website: 'Australia Dairy at a glance 2008/09'.

the removal of Price Discrimination provisions of the Trade Practices Act... enabled major supermarket chains to force their milk suppliers to supply their home brand milk at a considerably lower cost than for the branded milk, which...seems to result in a 'waterbed effect' and growing price differential between branded and generic products."

Exploring this issue further, in a recent report the ACCC observed that "Major Supermarkets' bargaining power for the supply of private label products means that the increases in production costs are not being fully reflected in the wholesale or retail prices for private label milk"

Industry players recently announced they were working towards increasing product innovation to counteract the rise of private label⁵. However, the structural challenges remain – as outlined by a senior executive of a major dairy processor recently: "This is a month to month challenge" as the retailing end has the smallest risk of investment per litre and highest profit per litre while at the farming end it has the highest risk of investment per litre and the lowest profit.

Increased difficulties in pricing: According to Dee Margetts, the removal of price regulated state markets under National Competition Policy a decade ago has contributed to the reduction of numbers of small milk farmers, who have not been able to obtain profitable returns. There has been a trend by farmers to consolidate operations to become more efficient so that processors could offer more competitive prices to retailers on a long term contract basis (80 per cent of milk by volume is contracted today). This strategy might prove risky in case of drought conditions which put pressure on costs models for such agreements and might result in more players exiting the production side of the business and reducing the supply base for the Australian market.

Future directions

There are a number of options designed to address these challenges that are being discussed in industry circles. One of them involves closer dialogue and co-operation between dairy processors and manufacturers in order to regain a level playing field in the value chain dialogue with retailers.

Another theme revolves around increased drive to innovation and differentiation by dairy processors to allow them to move away from competing purely on price in a commoditised market.

Taking this discussion to a more holistic level – the evidence suggests that there are no easy answers to the current structural issues in the value chain. The economic profits at the production level seem to be harder to come by, and innovation into new products may be at risk, due to price disadvantages that the new branded goods may have to overcome from the cost transfer to support growing penetration of private label products at retail level.

In the short term, one can argue that Australian consumers are winning due to lower prices of private label milk through major supermarkets. In the longer term the conclusions are less clear as the pipeline of new products is slowing down (affecting choice) and production capacity is jeopardized (which will put upward pressures on prices eventually).

5. Article published in 'Queensland Country Life' on 4 September 2010.



5.4 Private label case study

Industry context and background

Private label or house-brand products have significantly increased in popularity in Australia in recent years. According to recent AC Nielsen research quoted in the Australian Financial Review (17 May 2010), 22.8 per cent of grocery sales in Australia are now accounted for by private label goods. In terms of market penetration, Australia remains behind compared to the levels of private label sales in Europe and the U.S. – mainly driven by historical resistance by Australian consumers. Although the penetration of private label at retail level is visible, its importance at manufacturing (make) level in the value chain is harder to ascertain. Nevertheless, an estimated 57 per cent of Australian grocery related manufacturers are supplying private label to retailers⁶.

Current trends

Penetration of private label goods is highly category sensitive. Some categories such as milk are increasingly marketed under private labels whilst other such as health and personal care products remain highly aligned with branded products. In September 2009, according to Aztec Synovate, the private label Stock Keeping Unit (SKU) share was 17.1 per cent for Woolworth, 19.8 per cent for Coles, 12 per cent for IGA and 93 per cent for Aldi. All of the retailers are planning to increase their private label share, from 20 per cent to more than 30 per cent⁷.

Issues & challenges

The key discussions in the industry in this context relate to achieving balance of providing value based generic products to consumers while maintaining the rates of innovation and new products introductions to grow the overall market.

According to the AFGC 'State of the industry 2009' report, capital expenditure in Australia grocery manufacturing sector declined by nine per cent between 2000 and 2006 and a further 35.6 per cent decline (year on year) in the 'State of the industry 2010' report. This has manifested itself in lower rates of new product introductions and choices for Australian consumers. There is considerable discussion as to the potential driving forces for this trend:

- Major retailers are using their significant bargaining power and guarantee to stock the items on their shelves as a tool to secure private label products contracts from brand focused manufacturers. Over time, it may have the effect of encouraging manufacturers to concentrate increasingly on private label volume production to the detriment of introduction of new products
- Off-shoring of the production for certain private label commodities is also replacing some of the local capacity, to the potential detriment of local innovation and introduction of new products

In contrast, there are examples of companies – such as Procter & Gamble and Nestle - which do not actively pursue these opportunities and retain their focus on nurturing their equity through branded goods production.

6. Australian Food News article, January 2009.

7. Australian Food news article 'Australian supermarkets strengthen private label push', May 21st 2009.

It is evident that the move to providing private label products and production capacity has wide implications for manufacturers, ones that go beyond utilisation of spare production capacity. The strategic intent of introducing private label products alongside existing ones needs to be carefully analysed. The costs components such as logistics, warehousing and distribution should be carefully assessed as the total cost of ownership (TCO) may differ between branded and private label products.

The expansion of private label ranges needs to be a considered one from the retailer perspective as well. According to several executives in the industry, private label benefits need to be contextualised to the overall P&L effect and not just to the incremental profit margins. Ten to 20 per cent difference in margin, combined with the latent consumer demand to buy the products would form good foundations for considering the introduction of a private label product. This would cover the additional direct costs that a retailer needs to absorb to make the introduction a commercially viable proposition. Lastly, quality and safety standards from overseas sourced products may differ from Australian standards and need to form part of the evaluation process for a retailer. Risk in this space is usually lower on branded products versus private label products sourced from overseas.

Future directions

According to several executives in the industry, private label will continue to grow but will increasingly be more focused as its relevance varies across grocery categories. Overall profitability of the proposition will be the key determining factor, with major players such as Woolworths, Coles and Metcash very much in a position to decide where to take the end offer and how to deal with hard-discount chains such as ALDI and club-stores such as Costco. Success will be based on the ability to differentiate the offer not only on price but also on quality to attract and retain the loyalty of shoppers.



About NARGA

The National Association of Retail Grocers of Australia is a federation of industry associations representing about 4500 independently owned and operated grocery retailing businesses in all states and territories.

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