ADDRESS TO THE NATIONAL PRESS CLUB
BY MR JOHN CUMMINGS,
CHAIRMAN
NATIONAL ASSOCIATION OF RETAIL GROCERS OF AUSTRALIA

Woolworths and Coles: bad news for consumers, disastrous for business

National Press Club
16 National Circuit,Canberra
26 March 2008

Mr President, Directors, Ladies and Gentlemen,

I am here today to address the National Press Club in my capacity as the Chairman of the National Association of Retail Grocers of Australia (NARGA). My credential to be Chairman of NARGA is that I am a part owner of three independent supermarkets in Perth that trade under the IGA banner.

In that capacity I can report to you that business is very good in Perth for independents, as it is in a lot of Australia, but more of that later.

All of us, every man, woman and child in Australia has a very direct interest in grocery prices. If prices are unnecessarily high, we are robbed of choosing where and how to spend our own money, because we all need to eat, drink, wash and clean.

It is important that the system works as it should or we all suffer, but especially those who have low incomes.

That is why we commend the Assistant Treasurer, Chris Bowen, for the speed with which he established the Grocery Prices Inquiry after coming to office. He has seen that there is something wrong: prices here seem to be higher than they should be, compared with CPI and international indicators. He wants to know why and he has asked the Australian Competition and Consumer Commission to find the answers. It won't be Mr Bowen's fault if they don't, because he has been outstanding in his willingness to acknowledge there is an issue and to address it.

During my 35 years of business including the last 19 owning my own business I have interacted with many businesses around Australia as either a supplier or manufacturer or retailer and I am able to pass comment on the operations of small to medium size enterprises (SMEs) and the negative effect that the market dominance of Coles (now Wesfarmers/Coles) and Woolworths has on a great number of those businesses in Australia.

I have heard the Prime Minister state that we in Australia are riding on the wave of a resource boom in Australia. While I acknowledge that the resource sector is a major contributor to the economy and of course coming from WA would not like to see it falter in any way, especially as I wouldn't like to see my house value drop, I would contend that we are also continuing to ride the wave of retail trade in Australia and all the benefits a strong retail market brings.

Now let me share some of those retail figures with you.

In 2007, NARGA commissioned PricewaterhouseCoopers to assess the economic contribution of SMEs in the supermarket and grocery retail industry.

One of the motivations for the commissioning of this study was because NARGA as an industry lobby group, in its interaction with governments, political parties and government instrumentalities was often told we were the back bone of the economy and liked by all. But there didn't seem to be any real understanding of the contributions small businesses made.

So here are some of the figures from the report in 2007.

At that time, the economy turned over \$1 trillion.
Funds under management totalled \$1.3 trillion.
The ASX market capitalisation as at January 2007 was \$1.42 trillion.
The total wealth of family owned businesses in 2006 was estimated at \$4.3 trillion.

I would argue that one of the reasons why we have such an egalitarian society in Australia is because of that huge number in family owned business. Family owned businesses that share their wealth in the main in the community in which they operate.

Retail trade over the year to January 2007 was \$217 billion. Of that, almost \$89 billion was food retailing - and of that grocery retailing was estimated at \$74 billion.

Some of the headline figures of turnover in relation to employment:

- Retail turnover $217 billion and employs 1.5 million people or approximately 1.15 million full time equivalent.
- Resource sector revenue $120 billion, employees 80,000.
- Supermarket and grocery sector revenue $74 billion, employees 395,000.
- Combined with this activity is that food and beverage manufacture in Australia is the biggest sector of manufacturing accounting for 21% of value of all manufactured product. Of course the vast majority of this product finds its way to consumers via the supermarket.

The food and beverage manufacturing sector alone is made up of tens of thousands of SMEs engaged in either growing the produce, transport, processing, packaging etc employing hundreds of thousands of people.

Now we have a large industry employing a great number of people carrying out an important task. And who controls it? That's right Coles and Woolworths.

They have 79% of the grocery market yet of the estimated 6,183 grocery stores nationwide in 2006 they had a total of 1500 stores or only 22% of the outlets.

They have 79% of the market but employ only 43% of the people.

Woolworths submission to the ACCC Grocery Price Inquiry argues that they offer "range" - well, every grocery retailer offers "range", but Woolworths and Coles are culling theirs, delisting brands and replacing them with house brands, often imported.

If a consumer was to ask a staff member or manager of either Coles or Woolworths to stock a particular brand that they like I know what the answer will be. Ask an independent and if it is available they will have it on the shelf for you.

They say they offer - "best value" - well, they are price setters because of their market dominance, and they keep announcing record profits, so

I'm not sure they should be boasting about that - not to their customers, anyway.

And they claim to offer good service. If you've stood in a queue at a Woolworths or Coles checkout lately, you'll have had plenty of time to note the checkouts which are not open and working and you might have your own thoughts on the quality of their service.

In fact, a report in 2006 in *Business Review Wee*kly stated that:
"In spite of increasing its revenue by 75% since 2001, Woolworths has cut its workforce by 27% or 35,592 people [over the past 5 years]. Retail rival Coles has also slashed its workforce over the past five years, down from 160,000 in 2001 to 94,000". So much for service.

The two majors had a combined 35% market share in 1975 increasing to 79% by 2006.

It is worth noting that the current *Trade Practices Act* was introduced 1974, so if anybody thought that one of the intentions of the legislation was to prevent such an occurrence they must be disappointed.

As a matter of fact it would appear that the regulator has been sitting in the stands cheering on Woolworths and Coles since 1974 as the growth in market share has been constant and consistent.

Woolworths and some of their apologists would have you believe that their market share is far less, but the 79% figure comes from ACNeilson data that have been consistently used by all participants in the grocery industry for many years.

Woolworths, and Woolworths alone, now tries to make their market share appear smaller by mixing in ABS data for areas of food retailing in which Woolworths does not compete. They don't home deliver pizzas, they don't operate hamburger restaurants or cafes, they don't sell pies at sporting events, but they pretend they are in those markets and many others, just to make their market share seem smaller.

If we were to ask a company like Kelloggs who buys 80% of the retail packs of breakfast cereal they manufacture in Australia the answer will defiantly be Woolworths and Coles.

Woolworths and Coles market share in Australia is unparalleled anywhere else in the developed world.

Market share in the UK - top two, 48%; in the USA - top two, 20%.

But that is nowhere near the end of the story. They now have in excess of 50% of the retail petrol market in Australia and in excess of 50% of the packaged liquor market in Australia with full intention of taking that combined market share to 100% if allowed.

Their dominance of the retail market is such that it has been estimated by some analysts that the combined sales of Wesfarmer/Coles and Woolworths account for close to 40c of every retail dollar currently spent in Australia.

Surely one must ask: when will this stop?

The current inquiry into grocery prices being conducted by the ACCC will no doubt receive mixed messages regarding pricing and pricing practices around Australia.

But let me state a simple fact in regard to pricing of any goods or services: in any market, the more people there are offering the goods or services the lower the price to the consumer. Two competitors in a market is not enough.

Surely no-one believes that the cheapest petrol can be bought in a town or suburb where there is only one service station no matter what the brand of petrol sold.

Like-wise I would contend if you want cheap bread you will find the cheapest where there is a Coles, a Woolworths, an Aldi, and a couple of large independent stores in close proximity.

Clearly, you do not get competition when there is one seller. You do not get competition when there are two - you get market sharing, as I proved to my own satisfaction recently at Warringah Mall, in Sydney, when I priced a basket of products at Woolworths and Coles.

The goods I priced are market leader national brands that the industry treats as price sensitive - that is, we believe if you are not on the money with your competition on items like these it will have a negative effect on your overall sales

The prices were the same in each store. And they were about five per cent higher than in my own stores and Woolworths and Coles stores in

Perth, despite the extra transport costs.   Shoppers at Warringah Mall do not benefit from competition. They are victims of market sharing.

I was quite honestly surprised at the result.

As I mentioned before, I am a part owner of three independent supermarkets in Perth and we operate in a very competitive market. Some of our customers are on fixed incomes or pensions and let me assure you that nobody knows the price of groceries better than a pensioner, because they have to know.

I am sure that many of you have an elderly parent or relative to which you can equate this, but my father in law can quote every price he has paid when grocery shopping for the last four years. If he notices that prices are high he's out the door, never to return.

Now combine that tension with the fact that Perth has the highest percentage of independent grocery retailers in Australia - 32 per cent of sales there are through independents - and you get good honest competition. And, clearly, lower prices.

So how would I explain that the price of a can of Heinz baked beans cost $1.40 in Perth and $1.59 in Sydney, Coca Cola 2litre $2.99 in Perth and $3.15 in Sydney, while Nutri Grain is $4.89 in both cities.

I am at a total loss to explain it, except to point out that there are a large number of independents in Perth while far less in the Sydney metropolitan area. In Western Australia the independent sector has 32% of the market while in Sydney it is less than 10%.

With Woolworths and Coles market share at 80 per cent, Australia's grocery industry is hyper-concentrated. The UK Competition Commission has found that with their five big supermarket chains sharing 80 per cent of the market, there has already been evidence of an adverse impact on competition.

If we don't do something about hyper-concentration now, we'll arrive where we're headed.

Let me address the proposition that Woolworths and Coles have "won" their market share because customers have voted with their feet.

It is not safe to assume that market share is the result of "competition" in a hyper-concentrated market. Shoppers' options are limited.

Woolworths and Coles market share is largely the result of the fact that they dominate prime sites: high traffic, high volume sites in major shopping centres. Hyper-concentration in grocery retailing is exacerbated by concentration in shopping centre development. Many people do not have a genuine choice of where to shop in their local area.

The chain supermarkets often have a monopoly in a local market or they share it as a duopoly. They have no interest in competition. Why would they?

Shoppers are working longer hours, they are stressed, harried, time-poor and harassed. They shop at Woolworths and Coles because they must, not necessarily because they choose to shop there.

Quite often they are looking for fresh products and just the ingredients for the evening meal. Grocery shopping is no longer buying a fortnight's food and preparing meals around what is in the pantry. We are the pantry of the young urban dweller.

As we have seen, the quality of their service is poor, their range is being undermined by their own strategy of delisting branded products and replacing them with house brands nobody has asked for.

It is no surprise then that the majority of submissions to the Grocery Prices Inquiry have been from ordinary shoppers who are hostile to Woolworths and Coles. People are angry. They certainly believe that prices have increased beyond a reasonable point and they know very well that market domination has something to do with it.

Woolworths recent half yearly result put them on line to a profit before interest and tax in excess of $2.65 billion with the Australian supermarket division taking credit for over 75% of that profit. Coles have set as their agenda to at least match this performance and perhaps surpass it. Will we see both companies taking in excess of $4 billion from supermarket shoppers while still telling them they are getting "best value" for their dollar?

That is why there is a growing list of communities which simply don't want Woolworths or Coles to come into town: Maleny in Queensland, Oatley in Sydney, Woodford in Queensland, Mt Evelyn in Victoria - local communities are fighting to keep the chains out.

They know that local businesses will be targeted: the greengrocer, the butcher, the newsagency, the baker - they know that the extra jobs the supermarket chains promise will be mostly part-time jobs for juniors, while more jobs will be lost as local small businesses falter.

Why do people object to Woolworths and Coles arrival, if the benefits are so overwhelming? Perhaps it's because people know from long experience that when Woolworths and Coles come to town they change the nature of the place, they bring more traffic, more noise, not only during the day but in the middle of the night when the trucks arrive to make deliveries.

They know that Woolworths and Coles don't buy their products and services locally. They don't even bank locally.

Local primary producers and processors will also suffer when either of the chains enters a new local market. Fresh food will be trucked in from perhaps thousands of kilometres away, perhaps imported from countries which do not have the same high regard for hygiene, food safety or food security as we do. They know that the cleanest paddocks in the world might end up idle and unproductive.

They know, deep down, that the communities they chose to settle in will be changed. And not for the better.

But the chains are coming to town, ready or not.

And what of the broader perspective? Where are we headed?

Australia no longer produces tinplate. Will we still have canned fruit and vegetables from local producers in five years time? If the duopoly with 80 per cent of the market thinks it can stretch its profit margins by importing food, what chance for primary industry and local processors?

Many of the submissions to the current ACCC inquiry have pointed to the way Woolworths and Coles treat their suppliers.

Let us look at the milk market. I refer to figures from the Western Australian market, but they are typical of what is happening throughout Australia.

Coles and Woolworths are selling two litres of house brand low fat milk for \$2.99. Of that, \$1.29 (82%) of gross profit is available to the supermarket chains, the processor gets $1.00 of which 25 cents (16%) is profit, the farmer gets 70 cents of which four cents (2%) is profit.

But the picture is very different for branded milk, sold primarily by the independent sector. The retail price for two litres is $3.25 of which retail gross profit is 70 cents (38%), the processor gets $1.85 of which $1.10 (60 per cent) is profit and the poor farmer still gets 70 cents of which four cents (2%) is profit.

This is an illustration of what has been called the waterbed effect: the big body in the bed forces the smaller bodies to rise. The processor must increase the price charged independents to compensate for the price he is forced to take from the chains. The processor, in turn, cannot afford to give the farmer any more than the barest profit margin.

Linda Evangelista, the American model, once said she wouldn't get out of bed for less than $10,000 a day, yet we expect farmers to get out of bed before dawn for four cents a litre.

Well guess what farmers stopped getting out of bed. Unfortunately they did not have Linda to share the bed and all they ended up with was a farm that could not give them a reasonable return.

That situation is not sustainable. There is a national shortfall of milk production at present and it's only marginally related to drought. Part of the problem is that farmers are leaving their land. In many cases they are young farmers, good farmers who simply can't see a sufficient return for their efforts. That situation points to even greater problems in the future.

WA supplies of fresh milk continue to fall with forecasts supply will be short by up to 85 million litres over the next 2 years. Processors are currently trucking milk over the Nullabor from the eastern states to meet shortages. This brings into question food miles where the carbon footprint of food is greatly increased if you are forced to transport milk over 2000 kms versus the current 100 kms to processor and consumer.

All of this is directly the result of the hyper-concentration of the grocery industry in the hands of Woolworths and Coles. They have accumulated so much market power that they can increase prices at will.

Can that situation be changed? Only by more competition.

A recent study by economists at Oxford University found that the supermarket chains there - remember that the top five UK chains have 80 per cent of the market, compared with Woolworths and Coles 80 per cent here - the UK supermarkets are estimated to be taking 90 per cent of the profits available in the supply chain. Everyone else shares the remaining 10 per cent.

We have said publicly and privately on many occasions that we believe all stakeholders in the industry need to be receiving a fair share of the profits so that they can plan, reinvest, innovate and grow. They can't do any of those things if they are not getting their fair share.

The National Association of Retail Grocers of Australia is pro-competition. We do not seek subsidies or grants or protection. We do seek reforms which will allow independent supermarkets to compete more effectively with Woolworths and Coles.

There are a number of indicators of the anti-competitive consequences of market hyper-concentration.

One is that Woolworths and Coles dominate prime sites and prevent the entry of new competitors.

Even international giants such as Aldi - a family company with global turnover bigger than that of the entire Australian retail grocery industry - and Costco, the American company which runs warehouse-style mega-stores, have had difficulty establishing themselves in the Australian market.

Like Australian independents they have not been able to acquire suitable sites to fit their plans.

That inability to enter the market and/or access sites to increase market share is also an indicator of the anti-competitive effects of the hyper-concentration of the Australian grocery industry.

To have a company the size of Aldi complain about the negative effect on their business that the market share of Coles and Woolworths is having I find amusing when I recall the sometimes devastating effect that market domination has had on small business in Australia and the apparent lack of help offered to those businesses by governments.

Assuming that the major political parties share a pro-competition philosophy, which they do, it is ironic that such policies can be neurtralised by the decisions of local government planners.

Development applications are routinely approved by local governments without any consideration of competition issues. There is no public benefit test applied in relation to impacts on competition and, consequently, many local markets can be locked up as monopoly or duopoly arrangements for decades, with little hope that such anti-competitive situations can be reversed.

We have counted eight shopping centres where there are Coles supermarkets at the front of the complex and Bi-Lo - the other Coles banner - at the back, giving a sham impression of competition.

There are other sites where Woolworths and Coles share local markets, but with little sign of genuine competition. Warringah Mall in Sydney is a case in point.

And we read that there are contractual arrangements between the chains and landlords to deter the entry of new competitors.

These are all matters we hope the ACCC will investigate in greater detail.

Another indicator of anti-competitive behaviour arising from hyper-concentration is that suppliers are at the mercy of Coles and Woolworths.

In its submission to the ACCC inquiry, George Weston Foods pointed out that the increasing introduction of private label products by the chains has put pressure on Australian food and grocery manufacturers.

They acknowledged that all of their brands were at risk of being delisted by Woolworths or Coles and that "many enduring national brands are disappearing" because of the exercise of market power by the two supermarket chains.

In fact, in many instances the independent sector provides the first market for a new product or brand to establish itself. Quite often small manufacturers cannot afford the high cost of having their brands ranged by the majors who can charge up front slotting fees of in excess of $1 million just to get the product on the shelf. There are many established brands today in Australia whose first customer was not Coles or Woolworths.

We have also pointed to the repeal of s49 of the *Trade Practices Act* on the recommendation of the Hilmer Committee in 1993 as another vehicle by which the chains can extract anti-competitive advantage.

That section prohibited price-discrimination. Hilmer argued that it was not needed because s46 - the section that deals with misuse of market power - would do the job. Subsequently s46 was gutted by the High Court, so s49 might have been useful after all.

Price-discrimination is NOT about economies of scale. Economies of scale would still apply for larger customers.

Anti-competitive price discrimination occurs where a large retailer is able to demand lower prices than a supplier can sustain. We see it particularly in the supply of milk. The dairy processor is then obliged to charge competitors of the large retailer a higher price to offset the discriminatory prices extracted by the large retailer under threat of bringing product in from interstate or overseas.

In effect, because of the size of the large retailer's order, the supplier cannot say no. The supplier cannot afford to lose 45 or 35 per cent of their total sales - depending on whether he's talking to Woolworths or Coles.

That supplier's smaller customers must then bear an increased cost, effectively forcing them to cross-subsidise their bigger competitors.

We have suggested that s49 should be reintroduced or that similar provisions be introduced to s46 to strengthen the position of suppliers in resisting such anti-competitive conduct by the chains.

Predatory pricing is another issue which needs further attention during the ACCC inquiry.

We all know that Woolworths and Coles publish weekly specials which apply across all stores State-wide.

Woolworths, in several instances, has recently been publishing a separate brochure, under-cutting their own State-wide specials to try to damage a local independent grocer.

Is it predatory pricing? We can't be sure because we can't know whether Woolworths is selling those products below cost. Only the ACCC could establish that.

The so-called Birdsville amendment, introduced last year by Senator Barnaby Joyce, was a valuable statement of principle. It indicated that the Parliament of Australia did not condone predatory pricing.

But the legal detail remains untested in court.

A breach of s46 (1AA) requires a party having "a substantial share of a market" - however a court might define it - to sell product below relevant costs - and only the ACCC has the power to establish that - for a sustained period, however that might be defined.

And, for it to be illegal it must be with the purpose of eliminating or substantially damaging a competitor or preventing the entry of a person into a market or deterring or preventing a person from engaging in competitive conduct.

Clearly, none of that is easy to prove. And for a small business competitor to consider taking such a matter to court is simply out of the question. No small business can afford to spend a million dollars and wait for a decade until the case reaches the High Court.

Imagine our surprise then, to read that the Chairman of the ACCC, Graeme Samuel, went on the record in a recent speech in Sydney, saying that the Commission itself would not necessarily be the first to bring such a case - that it might be left to a small competitor to do so.

In the grocery industry, hyper-concentration of the market has made it simply impossible for a small player to take a case against a multi-billion dollar competitor.

Mr Samuel ought to know that.

The ACCC was the obvious agency to conduct the current Grocery Prices Inquiry. The Assistant Treasurer, Mr Chris Bowen, quite properly handed the inquiry to them.

But they have form.

The previous government asked the ACCC to report on petrol pricing and the best the ACCC could do was come up with a report which said not much at all.

And that in an industry with, effectively, only four product lines. What will they be able to make of an industry in which a major supermarket might carry 25,000 different product lines?

The ACCC's report to the Senate in 2002 included a couple of "models" of how the Commission thought the supply chain worked for the chains and the independent sector. The models revealed that the ACCC did not know how the supply chain worked in either case.

And in many of the ACCC's cases the line of thought is not transparent, statements are made and accepted *in camera* or under commercial-in-confidence provisions - statements which are concealed from competitors and never open to challenge or analysis.

The sale of Foodland Associated Limited's Action supermarkets in Western Australia and Queensland is a case in point.

The ACCC accepted statements about pricing by Woolworths which were never made public and therefore never open to public challenge.

Yet we do question those statements.

The ACCC has also been asked to investigate the supply chain of the grocery sector. This is a very difficult and complex task to complete. It is not simply looking at a tomato grower who sends off his produce to market, then to a retailer who pops it on the shelf for the customer to buy and take home to eat.

Is the tomato for a co-op to can? For a manufacturer to make into sauce or a paste which might then be used as an ingredient to manufacture another product to be packaged and put on the supermarket shelf?

This supply chain includes thousands of farmers, transport contractors, markets, small manufacturers, large manufacturers, packaging suppliers, etc all interacting to end up with the product to appear on the shelf for the consumer.

The task that the ACCC has been set is vast and complex. It goes beyond the simple recording of grocery prices around Australia.

To come up with a meaningful outcome the ACCC will need to start with the premise that the concentration of the grocery sector is unhealthy.

That the 80% market share of Coles and Woolworths is too much.

That the market dominance of the duopoly prevents competition from thriving.

That manufacturers of our foods in Australia are being done over on a daily basis by the practices of those two companies.

That farmers need to see some transparencies in the supply chain to ensure they have a sustainable business so we continue to source the vast majority of our food from the cleanest paddocks in the world.

The ACCC need to take us all to that so far unachievable place in Australia - the level playing field.

We, above all, hope they can take us there and sincerely ask all political parties to get us there quickly.

When Coles and Woolworths have 100% of the market there is no turning back.