Australian Dairy Products Federation

Submission

ACCC Supermarkets inquiry August 2024 interim report

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ADPF Submission to:
ACCC Supermarkets Inquiry 2024/25
Interim report response | submitted: Friday 1 November 2024

Acknowledgement of Country

Australian Dairy Products Federation acknowledges the Traditional Owners of Country throughout Australia. We pay our respects to Elders past and present.

Terms of Reference

This submission responds to specific key issues in Box 1.1 of the Australian Competition and Consumer Commission (ACCC) Supermarkets Interim Report 2024-25 released August 2024.

The Australian Dairy Products Federation (ADPF) has engaged with its members to develop our response. We have opted to comment broadly on key areas outlined in the Key issues box to which we can provide a comprehensive analysis of the current operating environment and the implications and risks to the dairy processing sector, as a consequence of the major supermarkets disproportionate control. Those being:

A. **Supermarket price setting practices.**
B. **Consumer experience.**
C. **Retail competition and supermarket margins.**
D. **Grocery supply chains.**

We complement this, by first providing an overview of the Australian dairy processing industry, the categories in which they operate, and the economic value they provide through job creation and investment in the vibrancy and livelihoods of the people and community in which they live and work. All potentially at threat.

About ADPF

The Australian Dairy Products Federation (ADPF) is the national industry policy and advocacy body representing commercial, post farm-gate members of the Australian dairy supply chain including processors, traders and marketers of Australian dairy products.

Our members process more than 90 per cent of Australian milk volumes and provide dairy products for both domestic and export markets.

For about 40 years, ADPF has strived to protect and promote dairy for the future success of dairy processors, providing a trusted source of advice and lead on public advocacy to government and the community, on the economic, social and health benefits of Australian dairy.

Executive summary

Delivering affordable, safe, and nutritious dairy products every day to Australian consumers is at the heart of our dairy processing businesses.

They are vital to our nation's economy, food security and regional development, transforming raw milk into value-added dairy products every day of the year – milk, cheese, yoghurt, butter, ice-cream.

These businesses keep more than 20,000 Australians in direct employment, more than half of whom are in regional Australia and a quarter, highly skilled. We pay $6.1 billion to our dairy farmers annually.

We are fortunate the demand for dairy products remains strong despite the cost inflationary pressure the sector is best managing.

However, off the back of COVID, floods and biosecurity threats, supply chain issues Australian dairy processors are contending with an extremely challenging operating environment. A combination of ongoing retail price pressures, low raw milk volume growth supply, persistent and rising input costs, compliance constraints, and competitive pressures are reshaping the Australian dairy industry. Thirteen dairy processing businesses have publicly announced their closure over the past 2 years.

You only have to look at our supermarket shelves to witness the range of cheaper imported dairy products available – cheeses, butter, ice cream.

Due to the perishability of dairy, the interdependencies between dairy farmers, processors and retailers are critical to ensure all elements of the industry operate efficiently.

However, the market imbalance and inequity in market power that exists between supermarkets and dairy processors is creating a competitively unfair market that must be addressed.

The aggressive promotion and leverage of home brand milk and other dairy products has removed a significant amount of value from the dairy value chain.

The entrance of the supermarket into the food service channel – and most recently into dairy processing – heightens this market imbalance and disproportional control, growing their dominance, market power and influence along the supply chain from product mix, to pricing, and sourcing.

This is coupled with the inability of the dairy processing sector to pass full input costs through the supply chain.

This submission not only emphasizes the financial pressures on dairy manufacturing but also details the hurdles faced by our members in one of the world's most concentrated supermarket sectors. The nature of this market has consistently squeezed the profitability of these suppliers, hindering reinvestment in this vital industry.

For Australian dairy processors this is eroding profit margins, reducing investment into capital, people, and innovation, and impacting industry confidence (at an all-time low of 17 per cent at the start of this year, versus 90 per cent in 2020) – and in turn has consequences downstream.

The ADPF commends the ACCC's attention to the distribution of risk and reward along the dairy supply chain. To address certain practices that lead to an unfair allocation of risk, we suggest a review of the protections under the Food and Grocery Code of Conduct (the Code) in which we have made separate comments to Treasury in our Code response.

Our submission also addresses the complications arising from the vertical integration and horizontal expansion of Australia's leading supermarkets. This trend forces dairy processors to interact with supermarket-owned or controlled entities at various stages of the supply chain, creating numerous competition-related challenges. The ADPF appreciates the Interim Report's focus on the growth of supermarket structures and believes these issues should be a key part of the ACCC's Final Report.

A. Supermarket price setting practices

The pricing dynamics in Australia's food and grocery sector are intricate, primarily steered by the retail market. Supermarkets leverage their purchasing power to shape the cost price increase process, where wholesale prices are negotiated. It's not simply a matter of suppliers setting wholesale prices and retailers setting retail prices. Instead, major retailers scrutinize suppliers' wholesale prices and influence other critical financial aspects of their commercial relationship.

Retail shelf prices are fully controlled by the supermarket and any rhetoric from the retailers that counters this is false. Wholesale prices are set by our suppliers but heavily influenced by the supermarket through the cost price increase "negotiation" process. Promotional investment is dictated by supermarkets as to how, when, and which products are promoted, often featuring additional investments from suppliers to bolster or increase retailer's own margins, such as margin support payments.

There has been a lot of focus on the changes in product prices since inflation began, especially in the public media under the guise of a cost-of-living crisis. The ADPF believes that looking only at this recent period doesn't tell the whole story.

Dairy processors constantly seek ways to manage or absorb rising costs. However, like any industry, they can't absorb all cost increases. Therefore, some costs must be passed on to retail customers to stay profitable and continue investing and employing over time. Fierce price competition among retailers has limited dairy manufacturers' ability to recover rising input costs, reducing profitability and leading to stagnant investment.

Processors aiming to raise their wholesale prices to offset higher input costs must navigate a complex price increase process. They often face rigorous scrutiny from supermarkets, who demand justifications for price increases and request sensitive commercial information to evaluate which input costs have risen and by how much. Processors have become wary of disclosing cost details to supermarkets due to experiences of having this information used against them for example in private label supply contract negotiations. This exacerbates the market power imbalance where retailers have greater visibility into processors operations, giving them a negotiation advantage.

Whilst the ADPF is aware the revisions to the Food and Grocery Code of Conduct no longer require commercial information to be provided when justifying a price increase and for retailers to respond to a request for a price increase within 30 days, we still have concerns around the strength of wording and interpretation in this area. The fact remains, supermarkets are continuing to control more parts of the supply chain with the effect of further reducing margins.

The Australian dairy processing supply market is highly competitive, with product substitutability and supplier competition, especially with the proliferation of imports, keeping wholesale prices in check.

In our previous submission, we highlighted the competitive advantage erosion that has occurred in the Australian dairy industry against a more cost-efficient competitor set, especially out of New Zealand and the United States. In particular, we highlighted the FY2022-23 Dairy Australia figures reveal export volumes are down by 16 per cent or 137,308 tonnes, while import volumes are up 17 per cent, particularly from New Zealand.

The December 2023 Situation and Outlook also found:

- In 2022/23, close to 344 thousand tonnes of dairy was shipped into Australia or 2.2 billion litres of milk equivalents, largely from New Zealand (NZ), the United States (US) and Europe – the largest volume ever imported in a single season.

- The price difference between Australian and NZ dairy products was at an all-time high, in conjunction with widespread inflation ramping up cost pressures for both buyers and producers.
- This led to a 28.8 per cent rise in imports from NZ and a 16.1 per cent increase in product from the US over 2022/23.
- Imported product accounted for more than 40 per cent of the Australian butter market by volume last season, most of which originated from NZ.
- In 1999/2000, imports accounted for 11 per cent of Australian dairy consumption, whereas the most recent figures show closer to 30 per cent of dairy consumed is from overseas – up from 25 per cent the year prior.

Whilst we have seen a narrowing of the competitor gap in the first half of 2024 especially with the readjustment of milk costs from July 1, imports have established commanding market share and has built long term relationships with Australia supermarket buyers which will be long lasting.

We have the additional dynamic in our industry with increase vertical integration by the supermarkets, in-particular Coles. As mentioned in our previous submission, Coles is setting farmgate milk prices that are higher than the industry average, creating unrealistic and unsustainable pricing expectations for the remainder of the industry, and impacting the ability of dairy processors to be cost-competitive.

For example, the 2022-23 season the Coles expected weighted average southern region farmgate milk price was $10.40 per kilogram of milk solids, versus the expected weighted average southern region milk price for the industry of $9.60 per kilogram of milk solids – 8 per cent higher.

Again, for the 2023-24 season, Coles set expectations high, announcing an expected weighted average southern region farmgate milk price of around $10.30 per kilogram of milk solids (February 2023). Most of Coles milk was locked in at this price point for 3-year average contracts.

This season is no different (2024-25), with Coles announcing an expected weighted average southern region farmgate milk price of around $10.30-10.40 per kilogram of milk solids, versus $7.94-$8.20 per kilogram of milk solids from the rest of the dairy processing sector.
Through end-to-end control of pricing and supply, Coles has the option to pay the farmer more for their home brand milk and use other methods to recoup these costs to ensure they maintain their margins. On the surface this may be seen as a great boon to Australian farmers who were able to lock in these incredibly high contacts against the market average, but the longer-term ramifications to the industry are concerning.

Coles' concentration of buying milk against a higher returning bundle of products on the retail shelf has led to predatory 'acquisition' of milk, forcing large sectors of the dairy industry that have geared their business to lower returning products in the commodity, export, and foodservice sectors to pay a farmgate milk price that does not provide a return for this product.

The result is that we have an industry that is no longer export competitive and this is currently driving decision regarding rationalisation and closures of factories or businesses, as was highlighted at the start of our submission.

There is a clear market imbalance that exists between dairy processors and retailers, impacting the future viability of the Australian dairy processing sector.

Processors are also limited by the fact that setting a recommended retail price too high can reduce consumer demand, decrease factory throughput, and prevent them from recouping fixed costs.

Additionally, retailer control product ranging and can introduce competing brands, including private labels, if they perceive insufficient supplier competition or high pricing.

B. Consumer experience

Topical, has been the concerns around price discounting from the supermarkets and how this has mis-lead consumers. The supermarkets have “trained” the consumer to seek out and make purchasing decisions based on the price discount visible on shelf through the discount “ticket” application. This form of promotion has also been used as a tool of leverage in negotiations with suppliers on cost price increases. It has led to a very confusing environment for the consumer.

This has also been coupled with “shrinkflation” – where product sizes are amended without a price change. Once again, this is an activity that processors must consider especially with the increase of cost competitive imports. In these situations, shrinking product sizes is a viable option for suppliers, enabling consumers to continue enjoying Australian product while keeping retail price increases to a minimum.

The existing Unit Pricing Code, indicating the cost of a product per standard unit of measurement, addresses the issue in relation to the impacts of these on the consumer experience.

There is also concern from our members around an increase of promotional campaigns that set out to demonstrate that the supermarkets are taking a leading positive “corporate citizen” role in our industry whilst at the same time driving out category value, and delisting smaller company offerings. This is often misleading consumers around the real activity and the role the supermarkets play.

C. Retail competition and supermarket margins

The ineffectiveness of supermarket competition in Australia compared to other markets has been well reported. The Australian grocery retail sector is worth about $141 billion and expected to grow 4.6 per cent annually (CAGR 2024-28). It is dominated by four main retailers who account for 80 per cent of the market, with Woolworths and Coles continuing to hold 65 per cent of that share[1].

This has a particular significance in the Australian dairy category.

In FY2023-24, about 73 per cent of liquid milk sold in Australia sold in retail stores (by volume), versus 27 per cent outside of the retail store[2].

In the retail stores, 61 per cent of the volume sold was private label or home brand milk, compared to 47 per cent of the value – reflecting the lower-than-average price of generic label milk to the branded version.

This compares to FY22-23 when 52 per cent of total milk sales where private label (by volume) and 34per cent by value.

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[1] Nielsen Homescan data 2024 c/o Dairy Australia; Statistics 2024; Hunt Export Australian Market Overview 2024

[2] Nielsen Homescan data 2024 c/o Dairy Australia. Retail stores = supermarkets, independents (noting majority volume via main supermarkets).

Since 2009-10 to 2023-24, neither home brand nor branded milks have kept up with the all-groups CPI. Private label pricing has increased faster on average than branded.

Supermarkets frequently leverage their own-label milk as a bargaining tool against branded dairy products, sometimes refusing to stock or prominently display branded options unless the price of private-label milk is pushed to highly competitive but unsustainable lows.

The implications on the viability of a processor is severely tested upon the loss of a private label contract. The Australian dairy industry have several examples where plants have been built purely on the long term "promise" of supermarket volumes propping up these facilities especially in the liquid milk category.

In times of hardship, such as droughts, financial aid is often directed solely at fresh milk suppliers, leaving processors and farmers of other cherished dairy products—like cheese, yogurt, and ice cream—without needed support.

The ADPF has identified numerous cases where processors bear the brunt of unbalanced trade requirements or narrow margins dictated by supermarkets. This ongoing imbalance in retail margins is neither fair nor sustainable, as it shifts risk entirely onto dairy processors while reserving profits for supermarkets. As a result, the dairy industry loses essential resources needed for reinvestment, and future growth and employment.

Referencing the Interim Report and our previous submission, Australia's leading supermarkets have expanded both vertically and horizontally into several key adjacent sectors, such as food service, media advertising, data, and distribution. This expansion, often driven by mergers, acquisitions, and internal growth, has significant implications for dairy processors. As a result, supermarkets have become not only the main customers for processors, but also providers of various services that suppliers are being pushed to use.

This growth means that supermarkets now dominate a large portion of the retail market and are becoming major players in numerous related industries. Suppliers increasingly find themselves dealing with supermarket-affiliated companies or associated businesses at multiple points along the supply chain. Often, as a condition of doing business, suppliers are strongly encouraged to use supermarket-controlled services, which can sometimes be priced above market rates, thereby increasing the costs for suppliers and their dependence on supermarkets.

As previously stated, whilst the ADPF is aware the revisions to the Food and Grocery Code no longer require commercial disclosures when justifying a price increase and for retailers to respond within 30 days, the fact remains supermarkets control more parts of the supply chain.

Dairy processors are already susceptible to the demands of the major supermarkets, and with them controlling more parts of the supply chain, could have the effect of further reducing margins, reducing competition, and eroding the future sustainability and viability of the Australian dairy sector.

D. Grocery supply chains

We have already outlined the challenges dairy processors face in negotiating price increases, so here we will focus on the supermarket practices that influence processors capacity for making practical business decisions, as well as how risks and profits are distributed across the dairy supply chain.

A dairy processor might hold a large market share within a specific category, yet this doesn't automatically lead to strong bargaining leverage due to the abundance of other product choices and high substitutability in the market. We have seen this particularly play out with the increase of imports that the supermarkets have aggressively targeted as highlighted above.

Cost of living challenges illustrate how price sensitivity shapes consumer behaviour, as shoppers are actively seeking discounts, deals, and opting for lower-cost alternatives and supermarkets are taking the opportunity of a milk cost differential, especially with New Zealand, to erode Australian dairy processor market share.

So even with brand recognition and scale, dairy processors remain under competitive pressure from their broader market, which sees all products as interchangeable or substitutable by consumers based on features, pricing, and use across all categories.

Even the largest dairy processors encounter limitations in their negotiation power. While some may have access to alternative sales channels, like export markets, they have become less competitive as a global player. The reduction in the raw milk pool has taken product away from the highly competitive and volatile export market, increasing their exposure to domestic sales from 50%, to as much as 70% over a four-year period. The dependences on supermarket sales is now even greater, making it difficult for them to walk away from supermarket negotiations.

As we have also previously stated, dairy processors profit margins have been under severe pressure on all fronts but if you now add to this the increased weight of exposure to the supermarket sector, ultimately this has led to the demise of smaller players – not only in supermarket range delisting, but in total loss of business in the extreme examples.

More broadly, for the Australian dairy processing sector, it has impacted on confidence to invest in local manufacturing, in innovation, and in job creation.

In relation to information asymmetry, dairy processors frequently enter negotiations with supermarkets at a notable disadvantage, lacking the depth of information needed to strategize effectively and achieve favourable terms. This imbalance highlights a significant hurdle processors face due to supermarkets' dominant position and their extensive informational advantage.

The influence of this information gap is growing as retail data becomes increasingly central to strategic and operational decisions. With substantial investments in loyalty programs, data processing systems, and data science capabilities, major supermarkets now possess vast amounts of insights that guide their negotiations. Dairy processors, on the other hand, can only access curated data if they purchase it from the supermarket's data division. Those who choose not to buy, or in the case of smaller operators unable to afford to buy this data, face a severe information shortfall during negotiations. We have examples from members that have been advised in the extreme of product delisting based on performance qualifications, that they have been unable to substantiate or challenge due to lack of qualifying data. This is especially the case in relation to supermarket margin expectations.

In relation to trading terms, processors face shifting and unclear commercial arrangements with supermarkets regularly, which disrupts their ability to plan and operate with certainty. Common issues include layout fees, where suppliers are sometimes asked to contribute to layout changes on shelf that don't impact their products. Our members have reported that they feel compelled to pay these fees to maintain good retailer relations. Similar issues arise with display charges for end-of-aisle product placements, which has been a tool that the supermarkets have used increasingly of recent, but ultimately our members have advised that is has offered limited to no value.

Additional challenges include unexpected costs post-range reviews, where dairy processors, even after securing placement, may face unanticipated charges in final contracts. The criteria for range reviews also often lack transparency, with inconsistent guidelines leaving processors uncertain about how their products are assessed. We have been advised that large portions of the cost price increase that were successfully agreed on, have been eroded over time in the lead up to range reviews with the supermarkets focus on performance against the new price and the push to protect a position of a product through increased promotional funding. These practices have seen further margin erosion and ultimately create significant uncertainty, making it difficult for suppliers to plan, invest, and manage risk effectively.

Given these challenges, we have an opportunity to address an undue share of risk on Australian dairy processors through the Food and Grocery Code of Conduct, which has been a feature of our feedback to the Code review. The ADPF believes we need further focus in immediately addressing the disproportionate control in supplier-retailer relationships and ensure that processors are better shielded from unpredictable costs, lack of transparency, and shifting contract terms.

Strengthening the Code could provide clearer guidelines and enforceable standards, helping dairy processors to operate with greater confidence and fairness in their dealings with supermarkets.

Processors raising concerns with supermarkets due to fears of the impact this would have on their commercial relationship, is still a central theme we hear often from our members. There was hope that the new Code would assist in addressing this and alleviate this continued stress. However the revisions to the Code's dispute resolution process and new confidentiality measures through the Code Mediators, are not negating the fears of retribution and lack of trust when raising concerns.

Addressing this will require cultural change within supermarkets, clearer procedural safeguards, and consistent positive messaging from senior executives to foster better buyer-supplier relations.

Strengthening specific Code protections in order for this cultural shift to occur could improve supplier confidence by mitigating the fear of retaliatory actions.

The power imbalance and dependence on a concentrated retail market perpetuates this fear of retribution, which remains a core issue. Processors are generally reluctant to escalate disputes formally due to high costs, long timelines, and the potential to harm commercial relationships, often viewing legal recourse as a last-resort option with severe consequences. Instead, less escalatory dispute channels that offer confidentiality and binding outcomes are essential for encouraging suppliers to voice concerns without risking backlash.

On this basis there is a view amongst our members that we may have regressed with the 2024 Code review, with features of the voluntary code that were being used effectively in the negotiation process with the retailer. For example, a simple threat of advancing a complaint where the retailer was deemed in breach of the voluntary code, has now been removed replaced with a dispute resolution process deemed more litigious and drawn out, at a higher cost, and with potentially less confidentiality. As per our submission to the Code review, we ask the ACCC to review clauses in relation to the dispute mechanism process and its confidentiality – especially in relation to price negotiations, range reviews, and delisting. These areas, critical to our members, were overlooked in the recent review despite being part of the Terms of Reference.

A more robust Code will provide Australian dairy processors with a fairer, more balanced framework for addressing recurring industry challenges.

Conclusion

Dairy processors are dedicated to fostering a strong, trusted industry that supports jobs, drives economic growth, and enhances Australians' quality of life, rooted in the shared value of dairy across the nation.

To achieve this, fair market conditions are essential. Major supermarkets already hold substantial bargaining power, creating an imbalanced market that challenges the competitiveness and sustainability of dairy processors both locally and internationally.

The ADPF and its members welcome the chance to collaborate with the ACCC in this Inquiry to help shape policies that uplift business practices across the food and grocery sector. Together, we can enhance transparency, certainty, and trust, ensuring the stability and long-term success of the Australian dairy industry—free from excessive supermarket power.

Yours sincerely,

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