National Farmers' Federation

Submission to the
Discussion Paper on
"Creeping Acquisitions – the Way Forward" …

15 June 2009

National Farmers' Federation

Member Organisations

Australian Dairy Farmers

ADFA

AGFORCE

CANEGROWERS

CATTLE COUNCIL OF AUSTRALIA

COTTON AUSTRALIA

NSW Farmers Association

N.T.C.A Northern Territory Cattlemen's Assoc.

RGA Ricegrowers' Association of Australia Inc

SHEEPMEAT Council of Australia

TFGA

Victorian Farmers Federation

WOOLPRODUCERS AUSTRALIA

Contents

Executive Summary

- Creeping acquisition legislation has the potential to have significant effects on the Australian agricultural sector given the number of associated sectors that arguably demonstrate some of the market traits that give rise to creeping acquisition issues.
- Of these, the supermarket retail sector is particularly illustrative given that it has one of the most significant impacts on Australian farmers given the degree of rationalisation and shift in bargaining power that has evolved in the food retail market and as such has been the subject of a number of recent reviews.
- While Australian farmers can benefit from rationalisation, there are reservations that the *Trade Practices Act 1974* ('the TPA') in its current form has the ability to adequately protect the sector from the disadvantages of decreased bargaining power and as such substantiate an argument for a creeping acquisitions law.
- However, the introduction of a creeping acquisition law may inadvertently add increased regulatory and administrative costs to the industry, including farmer organisations such as grower cooperatives.
- Therefore, the NFF advocates further investigations on both upstream and downstream impacts of a creeping acquisitions law to enable a more informed decision regarding the potential need to implement such a law.

1. Introduction

The National Farmers' Federation
The National Farmers' Federation (NFF) was established in 1979 and is the peak national body representing farmers, and more broadly agriculture across Australia.

The NFF's membership comprises of all Australia's major agricultural commodities. Operating under a federated structure, individual farmers join their respective state farm organisation and/or national commodity council. These organisations collectively form the NFF.

Each of these state farm organisations and commodity council's deal with state-based 'grass roots' issues or commodity specific issues, respectively, while the NFF represents the agreed imperatives of all at the national and international level.

Agriculture & the Trade Practices Act
While agriculture represents approximately 3 per cent of Australia's Gross Domestic Product (GDP), it is estimated that the sector represents more than 40 per cent of the GDP of regional economies and as much 70-80 per cent in most small towns once multiplier effects are taken into account. Nationally, the sector makes up 17.2 per cent of Australia's workforce. This dependence on the agricultural sector makes the impact of any change in competition policy as having a significant and direct effect on the outcomes for regional Australia.

The Australian agricultural sector has some unique market characteristics that need to be considered in the context of this submission. While over the years the agricultural sector has seen significant consolidation (due in part to drought, market rationalisation and declining terms of trade), approximately 99 per cent of Australia's 155,000 farms are still family owned and operated and by most definitions would be regarded as 'small businesses'. It is a sector that has prided itself on being able to adapt to changing environments with a continued focus on productivity improvements. These gains have been demanded as the rural sector battles on-going drought, relentless cost increases and highly subsidised foreign competition.

The NFF believes that refining the acquisitions law by implementing a creeping acquisitions law, however well meaning, should not be done lightly.

The NFF is of the opinion that the Trade Practice Act 1974 ('the TPA') (and its associated guidelines) should not become more complicated, or open to interpretation, without good reason. For small participants in the marketplace, including many Australian farmers, the interpretation of trade practices law has become so complex that they are placed at disadvantage to those who can afford expensive legal advice and support.

It could be argued that it would be in the farm sector's best interest to provide the regulatory authority with a clear mandate relating to anti-competitive mergers, more or less as the TPA does today, and leave it to consider all aspects as it sees fit. That would be simpler and cater better for ongoing structural changes and changes in regulatory 'fashion'. That said, we can see that legislation should not remain stagnant for the sake of simply minimising the compliance costs for industry if that would have the effect of making the legislation's intent redundant.

The NFF supports the intent of the inquiry, that is, ensuring existing competition policy is sufficiently armed to promote robust, efficient and most importantly fair markets in Australia, whatever their unique makeup and structure may be.

There are reservations that the TPA in its current form has the ability to adequately protect the sector from the disadvantages of decreased bargaining power and as such substantiate an argument for a creeping acquisitions law.

On balance however, it appears that insufficient research and evidence gathering has been undertaken to prove that certain markets have evolved in such a way that they are not being sufficiently regulated by existing competition policy. Until such a time that this evidence is produced, it would appear that creeping acquisition legislation is unwarranted.

2. Creeping acquisitions & the farming sector

There are a number of industries that directly affect the Australian farming sector which it could be argued demonstrate some of the market traits that may give rise to creeping acquisition issues. Some of these include fertiliser manufacturers, grain handling and marketing, fuel distributors and supermarket sectors. Rather than analysing each sector individually, this submission will focus solely on the supermarket sector (based on the existing information that has come from recent reviews of the sector) noting however that the NFFs final position would be applied to all the aforementioned sectors.

This submission has consciously also not attempted to answer the specific questions raised in the 'Creeping Acquisitions – The Way Forward' discussion paper. This is due to the NFF's concluding view that considerable research is still needed to gather the required evidence to warrant the introduction of creeping acquisition legislative provisions.

Supermarkets and Australian farmers

Approximately one third of Australian produce is sold on the domestic market with supermarket chains representing a significant proportion of the downstream stakeholder. However the domestic supply chain process varies with the commodity being sold. For example, cattle and sheep-meat are produced on farm and then either sold to a feedlot or direct to an abattoir, with the product moving downstream to the retailer. Dairy farmers produce milk on the farm which is sold to a processor who develops the product which is then moved to the retail level. By comparison, horticultural products are predominantly sold at a market, usually via an intermediary, direct to the retailer.

As a result of Australian supermarket acquisition activity, the sector has seen significant supply chain rationalisation with a greater concentration of power in fewer retailers leading to a reduction in the available downstream options for farmers. One by-product of this rationalisation is the shift in bargaining power towards the buyer. As a consequence, ensuring there is sufficient competition and alternative supply chain options available to farmers at the retail level, is of paramount importance.

This rationalisation has resulted in Woolworths and Coles' market share increasing from approximately 35 per cent in 1975 to 80 per cent in 2006[1]. The increasing dominance of the two majors has had profound effects on the competitive dynamics of the sector, affecting rivals, customers and upstream suppliers. These developments have been offset to some degree by the emergence of other players as a 'third force', including IGA and Aldi. In addition a rise in fresh produce outlets and the consolidation of franchised food operations and other prepared food outlets – all of which compete with the two market leaders, have provided some competition to the two market leaders.

Coles and Woolworths have led the modernisation of the retail grocery sector by seizing the benefits of increased scale and rationalizing their wholesaling and transport operations. Efficiencies gained in these areas have spilled over to other players in affiliated markets. This can be seen in:

- shorter supply chains which have introduced savings into the transformation of raw product into retail goods; and
- an increased capacity for the food and fibre producers to deliver a differentiated and source-identified product that are increasingly being demanded by more affluent and environmentally-consciousness consumers.

Developments such as the replacement of externally branded product with supermarket home-brands have the potential to benefit participants at both ends of the chain. Farmers' stake in these innovations may end up being just as important as those in the rationalisation of product handling, storage and processing.

Notwithstanding these positive aspects, accruing 80 per cent of the supermarket market share has significantly altered the competitive dynamics of the food supply chain. The ACCC's 2008 inquiry into the competitiveness of retail prices for standard groceries ('the 2008 ACCC Grocery Inquiry'), found that 'Coles, Woolworths and Metcash have significant buyer power in relation to many packaged grocery products because many suppliers effectively have little option other than to deal with these buyers' (ACCC,2008;p.2)[2].

Ultimately, producers of primary products face a similarly narrow choice of outlets. Their situation is compounded by the largely decentralised market-structure at the producer level. Deregulation of agricultural marketing since the late 1990s has widened the choices open to grain producers somewhat, but not those of livestock producers or horticulturalists, especially not those for whom exporting is impractical. In addition most farmers find direct contracting with supermarkets an unsatisfactory alternative.

The 2008 ACCC Grocery Inquiry came to a number of positive conclusions about the state of competition in the sector, including the following:

---

[1] The Retailers Association submission to the Australian Treasury Discussion Paper – Creeping Acquisitions (dated 13/10/2008) Available - http://www.treasury.gov.au/contentitem.asp?NavId=066&ContentID=1422

[2] 'Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries, July 2008' http://www.accc.gov.au/content/index.phtml?itemId=838251 Accessed: 4 July 2009.

> 'The ACCC has not identified anything that is fundamentally wrong with the grocery supply chain. Evidence provided to the inquiry does not support the proposition that retail prices have risen while farm-gate prices have stagnated or declined. While there may be some instances where this has occurred, generally movements in farm-gate pricing are set by supply and demand in competitive markets. Changes in the wholesale prices that Coles, Woolworths and Metcash pay suppliers are reflected in movements in shelf prices over time.
>
> 'Coles, Woolworths and Metcash have significant buyer power in relation to many packaged grocery products because many suppliers effectively have little option other than to deal with these buyers. Competition between retailers is, however, sufficient to ensure that Coles and Woolworths cannot simply retain all of the benefits of the lower wholesale prices they extract—at least some of the benefits flow to consumers in the form of lower retail prices (ACCC,2008;p.xiv)[3].'

These findings do not adequately acknowledge the competitive forces directly facing farmers. While the ACCC concedes that the focus of the inquiry was at the retail level, the lack of attention to the commercial conditions at the farm-gate, limits the credibility of the report's findings relating to the extent of competition in the full supply chain.

Furthermore Smith (2006)[4], Cotterill (2006)[5] and Round (2006)[6] advocate that a much deeper understanding of the effects of the power of the two supermarket giants on society's welfare is required before an assessment of competition in the supply chain would be warranted.

3. Conclusion

Farmers have a significant stake in the efficiency of downstream markets including the grocery supply chain. Just as importantly upstream input supplier markets, including fuel and fertilisers, have a significant impact in the sector's ability to compete cost-effectively in international commodity markets.

Currently it is not clear that adding a clause to the TPA requiring creeping acquisitions to be explicitly addressed either across any of the supplier or downstream customer sectors generally, or specifically in regard to the supermarket sector, may not serve that interest.

---

[3] Ibid

[4] Smith, Rhonda (2006) ' The Australian grocery Industry: a competition perspective' Agricultural and Resource Economics, Vol 50 (1)

[5] Cotterill, Ronald (2006) 'Antitrust analysis of supermarkets: global concerns playing out in local markets' Agricultural and Resource Economics, Vol 50 (1)

[6] Round, David (2006) ' The power of two: squaring off with Australia's large supermarket chains' Agricultural and Resource Economics, Vol 50 (1)

As a consequence, the NFF advocates further investigations on both upstream and downstream impacts of a creeping acquisitions law including data sets and pricing patterns. Such analysis would provide the basis for a more informed decision regarding the potential need to implement creeping acquisition legislation.