Market Power in the Australian Food System

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Key Points

- Australia’s two largest supermarket chains - Coles and Woolworths - dominate the domestic food system.

- Greater diversity is needed in Australia’s food system, to allow equitable co-existence between small and local farming suppliers and retailers, and the supermarket giants.

- An improved balance between ‘buyer power’ and ‘seller power’ must be advocated and closely monitored, to ensure that unfair influence is avoided.

- Government policies must be put in place to protect and provide incentives for local farmers and suppliers within a competitive food system.

Summary

Supermarkets have an increasing role in the development of the Australian agricultural sector. An escalation in market share for Coles and Woolworths has created a challenging environment for many Australian farmers and suppliers. It has led to concerns that the current imbalance in market power, favouring the major supermarkets, is detrimental to Australia’s agricultural industry.

The major challenge is to ensure that an appropriate level of protection exists to allow the continued operation of small and medium-sized agribusinesses and retailers, to promote competition in the agricultural sector.
If it is not restrained, this power play may jeopardise the stability of Australia’s food system and also have wider food security implications.

The Food Market in Australia

The supermarket industry is dominated by a select group of retail entities, of which Wesfarmers (Coles) and Woolworths are Australia’s largest. Both companies have experienced substantial growth over the last four decades; more than doubling their combined market share to over 70 per cent of the country’s supermarket/grocery sector. The profitability of Coles and Woolworths has increased substantially; by 40 per cent and 24 per cent respectively. Further growth remains a real possibility.

Their considerable market power grants the two conglomerates the ability to determine prices, affect entry barriers and establish a level of expectation in the sector. This puts pressure on the rest of the food chain in Australia. Many local farmers are placed in a vulnerable position by decisions made by Coles and Woolworths, whether they involve pricing, the volume of transactions or other commercial strategies.

Concentrated Power in Australia’s Food System

Market power refers to a disproportionate influence over terms of trade. As retailers gradually increase their market share, they are able to consolidate their position within food supply chains. This includes expansion into the production, distribution and processing sectors.

Australian customers of Coles and Woolworths have experienced notable benefits from the growth of the two chains, particularly through improved access to more affordable products. These benefits, and their current advantages for Australian food security, cannot be understated.

Issues persist, however, as these measures ultimately risk the financial viability of many Australian farmers.

Advantages

Coles and Woolworths contribute substantially to the economic wealth of Australia. The two chains combined employ just short of 300,000 Australians. In addition to these employment opportunities, the magnitude of their operations provides the primary markets for local farmers, granting them broader access to end-consumers than is possible with smaller retailers.
Coles and Woolworths are able to meet consumer preferences with a range of products at reduced prices. The size of their buying operations allows them to dictate negotiating terms to obtain suitable produce at low cost.

These benefits are of particular importance to the public as they result in short-term food affordability. Over the last three years, Woolworths and Coles have decreased their prices, on average, by 11 per cent and six per cent respectively. Discounting strategies applied by both supermarkets improve the range of food options available to customers at lower prices.

**Issues**

The extensive market power of Coles and Woolworths, however, is also responsible for significant issues affecting domestic suppliers in the Australian food system. The shrinking market share of independent retailers leaves the majority of suppliers with little choice but to negotiate with the duopoly. This market environment ensures that the supermarket giants wield significant influence over price negotiation and standardisation demands.

**Retailer competition**

Wesfarmers and Woolworths are huge, diversified companies. Woolworths holds a portfolio of retail brands across general discount retail, hardware, electronics, groceries, liquor and hospitality. Wesfarmers extends even further; in addition to retail brands in groceries, liquor, hardware and office supplies, the company also has interests in insurance products, coal mining, industrial safety, chemical and fertiliser operations.

The grocery operations of both companies have increased steadily in value in recent years. This has been helped, in large part, by the ‘price wars’ between the competitors, which have helped to bring in customers. The diversification of Wesfarmers and Woolworths into other retail sectors and services ensures that they are shielded, in comparison to independent grocers, from minor food price pressures. This has created an uneven playing field in Australia’s grocery sector. Contrarily, both conglomerates can also raise grocery prices to address shortfalls in other sectors.

Coles’ and Woolworths’ outlets are now proliferating across both metropolitan and regional centres of Australia. The expansion of the duopoly is driving out smaller businesses, particularly in rural areas, which cannot compete with the major supermarkets. This equates to losses in employment and income for these family-owned ventures.

The restricted number of retail players has increased the dependency of suppliers on the supermarkets as a channel to reach end-consumers. This is depriving farmers and food producers of the flexibility and power to negotiate their contract terms.

**Marketing levies**

In their marketing messages, Coles and Woolworths often present themselves as sellers of ‘fresh’ and ‘local’ produce at low prices. Both chains are now using celebrity chefs, Curtis
Stone and Jamie Oliver respectively, to broadcast these marketing buzzwords to consumers. Such tactics are now reaching new and costly heights.

Recent reports reveal that Woolworths is passing the costs of its ‘Jamie’s Garden’ marketing campaign on to its vegetable suppliers; charging growers who wish to opt-in to the campaign an additional 40 cents per crate. Many growers already pay the chain a marketing levy of two and a half to five per cent to market their products. Woolworths’ spokespeople argue that it is entirely voluntary whether growers decide to opt-in and pay the new levy.

Many growers have voiced concern about these levies, arguing that they do not have a choice in the matter: either they pay the levy, or face the prospect of losing their contracts with Australia’s largest grocery chain. The ‘Jamie’s Garden’ case is an example of the ever-decreasing farm gate returns induced by the tactics of Australia’s powerful supermarket duopoly. As Coles and Woolworths continue to consolidate their closed-buyer supply chains, suppliers incur greater costs, weakening their long-term financial viability.

Bargain Price Marketing

Opposition to the concentrated power of the duopoly increased in 2011, when Coles and Woolworths sold milk at $1 per litre. This case exemplified the growing issue of anti-competitive behaviour by the two supermarket giants; both criticised for using their market power to disadvantage other retailers and dairy farmers.

Cheap milk marketing threatened the livelihood of local farmers, as reduced prices led to a decrease in farm-gate returns. The $1 per litre promotion diverted many consumers to home brand milk in this period, accounting for 72 per cent of Coles’ total milk sales in 2011. At the height of the ‘price war’, on average, farmers received between 20 to 30 cents for every litre of milk supplied to the supermarket giants, well below the cost of production for many dairy farmers.

The benefits that farmers gain from increased market exposure, may not be sufficient to cover their expenses and allow scope for re-investment in their businesses. This outcome may be manageable in the short-term; however, long-term promotions can result in sustained low profit margins for suppliers, risking the survival of small and medium-sized businesses in the agricultural sector. Indicatively, the 2011 pricing squeeze forced dozens of Australian dairy farmers, 30 in Queensland alone, into ‘selling up’ their farms.

Home-Branding

Anti-competitive practices have also been evident through the proliferation of privately labelled goods appearing on supermarket shelves. Coles and Woolworths are increasing their range of ‘Home-brand’ items, produced in conjunction with specific suppliers, under strict production demands. These products are being produced on a mass scale, often sold at the lowest prices and dominating prime shelf space. These items are not simply cheaper

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1 Closed buyer-driven supply chains: The links of production, distribution and processing involving transactions that are governed by contracts and pre-determined specifications, rather than the price at the time of purchase; Source: http://policyleadershipinstitute.org/documents/Food%20Retailers%20Buyer%20Power%20and%20Food%20Insecurity%20in%20the%20EU%20Ross.pdf
than ‘branded’ merchandise; they are making it more difficult and expensive for small, independent brands to obtain exposure within the major outlets and compete with the ‘home brands’.

The infiltration of these privately-labelled goods on supermarket shelves has, in fact, diminished the product range offered by Coles and Woolworths. Research from Deloitte found that Coles’ product range dropped by 11 per cent between mid-2010 and mid-2012. Responding to criticism of the lack of product choice for consumers, Coles argued that customers will ultimately decide what products they want to buy and can simply shop elsewhere. That choice is not afforded to all Australians, however; many customers, particularly in rural communities, no longer have access to affordable food retailers other than Coles and Woolworths.

These practices ultimately reduce the competitiveness and diversity in the domestic food system and run the risk of a supermarket-induced extinction of smaller, often family-owned, businesses and brands.

*Standardisation demands*

The standards and specifications for produce imposed by supermarkets have a significant influence on the food system. Retailer determined guidelines on production methods, size, shape and colour of produce, have been applied to cater for broad consumer markets.

Food standardisation creates increased pressure on farmers to provide an ‘ideal’ product. Many Australian suppliers are forced to comply with these demands, due to the importance of Coles and Woolworths to consumer access. Standardisation demands burden many suppliers with capital-intensive production processes. Other factors, such as packaging and traceability requirements, also add significant costs for small and medium suppliers who have not established economies of scale.

*Food Waste*

When items fail to meet the specifications expected by Coles and Woolworths, it results in high levels of food wastage. The perishable nature of fresh food means that any excess is likely to be wasted. The continuation of current levels of food waste, predominantly in the production and market stages of the supply chain, are not viable for Australia’s food security future. These issues are highlighted in a recent paper titled *Food Waste in Australia* by Future Directions International.

*Productivity vs. Ethics*

Product standardisation between Coles, Woolworths and their respective suppliers has been increasingly evident on store shelves. Home brand products, such as ‘RSPCA-approved’ eggs and chicken products, have now appeared in their retail outlets. Woolworths aims to remove all eggs that are not RSPCA-approved from their shelves by 2018.

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2 Economies of scale: The reduction in long-run average and marginal costs arise from an increase in the in size of an operating unit e.g. extensive land resources for large agri-businesses; Source: [http://www.businessdictionary.com/definition/economies-of-scale.html](http://www.businessdictionary.com/definition/economies-of-scale.html)
These production specifications are designed to comply with animal rights standards in egg and meat production. The Victorian Farmers Federation (VFF) claims, however, that these measures impose “enormous costs” on chicken meat, egg and pig producers. The VFF says that the trend in standards is moving towards “total bans on produce from some farming systems”. Coles and Woolworths claim that they are simply meeting consumer demand; instead, the two chains are effectively restricting the ability of many Australian suppliers to make their own decisions in a diversified, competitive food system.

This perspective from the VFF, echoed by other industry observers such as the Australian Farm Institute, seeks to encourage Coles and Woolworths to scale back their strict production demands on domestic suppliers. These demands, they argue, effectively ‘kill off’ productivity in Australian agriculture and ultimately pass on the new costs of production to Australian consumers.

**Implication and Analysis**

High debt levels and climate change, among other challenges, already overshadow the long-term financial viability of many Australian agri-businesses. The practices of Coles and Woolworths in the Australian food market are placing further pressure on domestic suppliers, as they experience ever-decreasing profit margins.

Deflationary cost pressures and production demands from Coles and Woolworths, force suppliers to make cutbacks in their operations. The measures the suppliers can take include: finding further production efficiencies (unlikely without excess money for investment), increasing production, cutting wages and externalising costs. These solutions may work for some suppliers; however, for many, the cost burdens will prove insurmountable in the long run.

To compete in the evolving market, suppliers will be forced to set up economies of scale, to absorb the extra costs of production. This will ultimately lead to increased centralisation in Australian food production.

Centralisation of Australia’s food production will mean a smaller pool of large agricultural suppliers, many of whom are engaged in monoculture production. This production model risks reducing bio-diversity among agricultural crops and other produce. As a result, increased threats to yield and food quality - such as pests, diseases and water stresses - will emerge, particularly as the effects of climate change intensify. Thus, the more centralised agricultural production becomes in Australia, the more vulnerable our food system is to environmental shocks.

Supermarket distribution networks and stock concentration also expose the food system to risks. A limited number of huge supermarket warehouses service Woolworths and Coles outlets in Australia’s capital cities. The concentration of products within these buildings increases the vulnerability of food resources to security and environmental risks. Minimal

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3 Monoculture: a model of agriculture in which a single crop variety is continuously planted in a given area. This model lends itself to industrial agricultural practices (e.g. mechanisation, high inputs) and economies of scale; Source: [http://policyleadershipinstitute.org/documents/Food%20Retailers%20Buyer%20Power%20and%20Food%20Insecurity%20in%20the%20EU%20Ross.pdf](http://policyleadershipinstitute.org/documents/Food%20Retailers%20Buyer%20Power%20and%20Food%20Insecurity%20in%20the%20EU%20Ross.pdf)
production and storage capacities in rural areas, furthermore, can result in the emergence of ‘food deserts’ leaving regional, predominantly Indigenous, populations with limited access to fresh and nutritious food.

This scenario will result in an unstable domestic food system; far more vulnerable to supply and price shocks. This, in turn, has negative implications for food accessibility and security in Australia.

The counter to these trends is to encourage smaller growers to promote greater diversity in Australia’s current food system. The remaining retailer market share in the system, other than Coles and Woolworths, is held by discount supermarket Aldi (growing above 10 per cent) and a fragmented section of tens of thousands of grocers. By empowering and protecting independent growers, market control will be allocated more evenly, giving local farmers more avenues to access consumers.

**Market Policy and Protections**

The *Consumer and Competition Act 2010* sets out the regulations against market power abuse and unfair pricing. The Australian Competition and Consumer Commission (ACCC) have oversight of retailers’ compliance with these protocols. It holds the authority to investigate any potential breach.

In 2013, the ACCC launched an investigation into the conduct of Coles and Woolworths, after numerous complaints from suppliers of misuse of power. The 18-month investigation led to enforcement action over claims of ‘unconscionable conduct’ by the two chains. The specific case against Coles, relating to, in part, using threatening tactics to obtain rebate payments, is set to return to the federal court in August 2014.

It is unlikely that the investigation will bring meaningful sanctions to Woolworths and Coles. The consumer watchdog has had limited success in such cases in the past, which is partially due to the vague definition of ‘unconscionable conduct’ in the ACCC’s legislation. Furthermore, if the chains were to be found guilty, the financial penalties or compensation is likely to be too menial to be a long-term deterrent to current retailer practices.

It is evident that there are fewer producers and suppliers currently operating in the domestic market; however, it is difficult for the ACCC to prove that the conduct of Coles and Woolworths is responsible for these results. The creation of further mechanisms is needed to provide both consumers and suppliers with extra protection and security from the overarching commercial practices of supermarkets.

**Recommendations**

**Code of Conduct**

Discussions on enforcing a ‘Voluntary Code of Conduct’ are taking place with the aim of addressing market manipulation. Endorsed by Coles, Woolworths and the Australian Food and Grocery Council, the Code would prevent supermarkets from altering contracts and using suppliers’ intellectual property to develop their own product labels. Major concerns
are present, however, in the failure of the code to address the inequality of market power in the supply chain.

If the Voluntary Code materialises, the ACCC will be required to monitor contractual discussions and ensure that parties comply and honour their commitments. Realistically, the governance of such measures is difficult. This highlights the need for stricter sanctions that preclude parties from contravening their agreements. The Australian government will be required to take additional measures and intervene in the event that serious breaches of the Code are committed.

The Code must also cover the prevention of the predatory pricing\(^4\) practices currently undertaken by the duopoly. Coles and Woolworths often negotiate for suppliers to sell their goods below cost-price during bargain promotions. Restrictions on predatory pricing of groceries exist in other nations, such as Germany, to prevent such practices, which often result in small farmers being forced out of the market.

Transparency is also a vital feature for the co-existence between supermarkets and local suppliers. The code must facilitate candid communication between all parties, to guarantee that its objectives are achieved without undermining other market players. It would be in the interest of all parties for the Code to explicitly stipulate honest and genuine conduct, violation of which would attract financial penalties.

*Review of Consumer and Competition Act 2010*

As with other existing policies, regular revision of the Consumer and Competition Act 2010 is required, particularly when allegations of unfair market practices persist. The Australian government (in particular through the ACCC) should be prepared to modify the policy or implement tougher penalties if the Voluntary Code fails to operate effectively.

*State Support*

It is unrealistic to suggest a sweeping Interventionist response from government to allegations of misuse of supermarket power in Australia. It is, however, important for government to improve protection and incentives for small and medium-sized farmers, to ensure the continuity of a diverse domestic food system. A 2013 OECD report revealed Australia ranks as one of the worst countries in the world for government-funded farm support, at three per cent of funding compared to total gross farm receipts in 2012.

State support in the form of developing regional marketing platforms is an example of how government can assist local growers. Through government funding and/or small contributions from suppliers, groups of producers can amalgamate under the banner of a particular region and build a brand that will appeal to a broader consumer market. Schemes such as these provide a platform for small agri-businesses to develop and can serve as a preferred option to fiscally-intensive industry subsidies.

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\(^4\) Predatory pricing (definition): The practice of temporarily selling below survival prices to undermine or eliminate existing competition. Source: [http://www.businessdictionary.com/definition/predatory-pricing.html](http://www.businessdictionary.com/definition/predatory-pricing.html)
The forthcoming release of the Agriculture Competitiveness White Paper will reveal the government’s policy intentions for curbing the market power of major supermarkets and/or providing incentives to small farmers to achieve that end.

Alternative Model

Australian farmers, in a bid to improve their solidarity in the food system, have the opportunity to form co-operatives. The number of co-ops in Australia, however, has decreased significantly in the last two decades. By reverting to this strategy, farmers can form large unified organisations, to improve their negotiating position with wholesalers and retailers. Farmers can also sell directly to consumers through those platforms.

There are inherent concerns, however, about establishing co-operatives. Farmers lack the backing from government to support such ventures. Maintaining a co-op structure requires substantial capital and potential debt loading from its members. For local farmers, while the notion of a co-op has obvious benefits, the financial risks involved may discourage many of them from entering co-op schemes.

Local farming groups, with the assistance of the Australian government, need to take a proactive stance that will give small farmers the incentive to undertake opportunities such as these to improve their solidarity in Australia’s food system.

Consumer Strategy

Consumer support for domestic farmers is particularly important to those producers who are not in partnerships with supermarkets and rely on local customers.

Australia is ranked among the top five nations in the world for food affordability, with an average spend of just over 10 per cent of household income. This enviable position allows many Australians to expend a slightly higher proportion of their incomes to support a diverse food system.

Purchasing products directly or through independent retailers, may be slightly more expensive than the retail prices in Coles and Woolworths; however, this difference could be the incentive that Australian farmers require to potentially compete with the duopoly.

The sustainability of the Australian food system is at stake.

To ensure the existence of a diverse range of food producers in Australia, it is important that the balance of power between buyer and seller in the Australian food system is restored. It is integral, however, that a shift in the system towards seller power is not so pronounced that suppliers can dictate retail prices above competitive levels, undermining the current standard of food accessibility in Australia.

Conclusion

Market power in the food system is a major concern in Australia. The powerful duopoly of Coles and Woolworths clearly presents challenges to small businesses and local farmers, who are struggling to co-exist with the supermarket giants.
Currently this market situation benefits consumers and will continue to do so in the short-term.

The financial pressures on small and medium food suppliers, such as deflationary price pressures and demands for increased production, however, are unsustainable and have the potential to threaten domestic food security.

Collaboration and transparency between suppliers and the supermarkets must be improved, to ensure that the strategies employed are not at the expense of a competitive food system.

Australia’s long-term food security depends on maintaining diversification of both producers and produce. Government mechanisms must be adopted to ensure that retailer behaviour does not impinge on the balance of power between buyers and sellers of Australian food. Further growth of the major retailers, left unrestrained, has the potential to destabilise Australia’s food system, to the detriment of the food security enjoyed by Australians today.

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