

ARA SUBMISSION

SELECT COMMITTEE ON GROCERY PRICING IN SOUTH AUSTRALIA

APRIL 2024

The Australian Retailers Association (ARA) welcomes the opportunity to provide comments to the Select Committee on Grocery Pricing in South Australia (SA).

The ARA is the oldest, largest, and most diverse national retail body, representing a \$420 billion sector that employs 1.4 million Australians – making retail the largest private sector employer in the country. As Australia's peak retail body, representing more than 120,000 retail shop fronts and online stores, the ARA informs, advocates, educates, protects, and unifies our independent, national, and international retail community.

We represent the full spectrum of Australian retail, from our largest national and international retailers to our small and medium sized members, who make up 95% of our membership. Our members operate across the country and in all categories - from food to fashion, hairdressing to hardware, and everything in between.

Specifically, we are proud to represent Australia's largest supermarket groups, Woolworths and Coles, as well as new entrants like Costco and Amazon. We welcome the opportunity to highlight the positive ways these companies support local communities and economies right along the retail value chain.

EXECUTIVE SUMMARY

Australia's grocery sector has changed significantly since the last inquiry into supermarkets was held by the Australian Competition and Consumer Commission (ACCC) in 2008, with large global players entering the local market, boosting competition for the benefit of Australian consumers.

These new entrants have entered the sector at a time when the growth of online shopping and extended trading hours have increased choice for consumers, and investment in technology and supply chain efficiency has increased the convenience and driven improvements in the shopping experience.

However, these improvements have coincided with significant increases in the cost of doing business - as a result of the pandemic, global conflict and natural disasters - that have resulted in higher prices for consumers.

There are currently numerous inquiries across the country looking into - or involving - Australia's largest supermarkets, in addition to the review into the Food and Grocery Code of Conduct. We note the following terms of reference for this inquiry in SA:

- a) The prices for groceries and staple goods and products at SA supermarkets and grocery stores, compared to other states in Australia;
- b) The disparities in grocery pricing between metropolitan and regional areas;
- c) The prices paid to local growers, producers and suppliers for goods and services compared to prices charged to consumers in SA supermarkets and grocery stores, and the reasons for these disparities;
- d) The impact of retail consumer pricing on consumers, particularly for those on low incomes;

- e) The prevalence of food insecurity in SA;
- f) The prevalence of price gouging practices and anti-competitive behaviour among grocery retailers and the impact on consumers;
- g) Potential opportunities for price monitoring, transparency in retail pricing and further regulation of pricing; and
- h) Any other related matters.

While we appreciate some of these concerns relate specifically to SA consumers and businesses along the retail value chain, our members operate national businesses within a national market. On that basis, this submission makes the following observations.

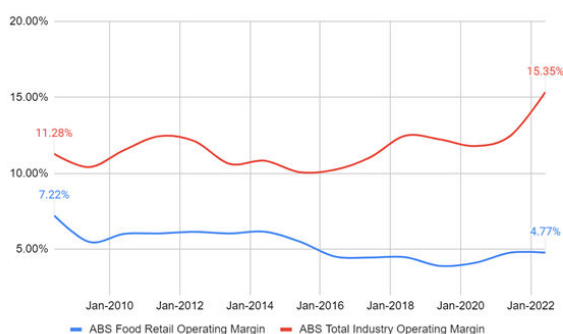
- The Australian food and grocery sector is value-driven and competitive, promoting consumer choice and convenience.
- The key driver of higher prices for consumers is higher costs for retailers.
- The data suggests that SA policy settings are adversely impacting SA consumers.
- The Food and Grocery Code of Conduct remains the best mechanism for managing disputes between retailers and suppliers.
- The evolution of online shopping and other mechanisms has created transparency in pricing without the need for regulation.

ARA POSITION

The Australian food and grocery sector is value-driven and competitive, promoting consumer choice and convenience

The last ACCC Inquiry into supermarkets in 2008 concluded that the sector was “workably competitive.” Since that time, new overseas entrants have entered the market or expanded their operations - creating more competition and more diverse shopping options for consumers.

These competitive forces have also put downward pressure on profits for Australian supermarkets, with Australian Bureau of Statistics (ABS) data confirming that Food Retailing Operating Margins have reduced from 7.2% in 2008, to 4.8% in 2022 (the last available data source). This trend is in contrast to the increase in Operating Margins across the broader economy over the same period.



Source: ABS Food Retailing Operating Margins

While Operating Profit across the sector have been in decline over the past 15 years, our members' Net Profit After Tax (NPAT) has remained largely stable in the past five years, with minor variation year on year. Importantly their margins are broadly comparable with leading global grocery retailers in Canada, UK and USA. Like those countries, Australian supermarkets operate in a highly competitive market.

Price remains a key driver of consumer choice, which drives intense competition between grocery retailers. Our members engage in vigorous competition to attract and retain consumers and deliver value for money. A summary of key areas of competition and differentiation include:

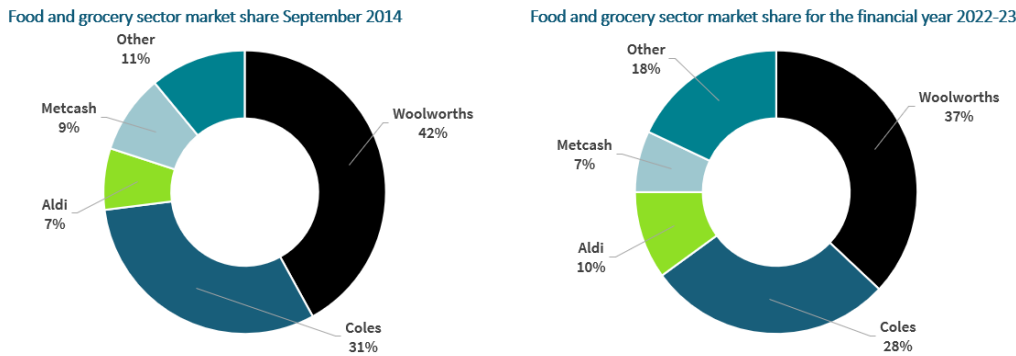
- **Price competition:** Competing on price remains a primary focus for our members. Promotional discounts and price matching are commonly used to offer competitive pricing and value to consumers.
- **Product range and quality:** Our members differentiate themselves by offering diverse product ranges encompassing various brands, quality tiers and specialty items. Emphasising high-quality products, including premium and organic options, helps attract consumers seeking superior value and experience.
- **Convenience and accessibility:** Convenient locations, extended opening hours and diverse shopping formats, including online and click-and-collect services, boost consumer accessibility and convenience. Supermarkets strive to meet evolving consumer lifestyles and preferences by providing flexible shopping options.
- **Loyalty and rewards programs:** Some of our members choose to invest in loyalty and rewards programs to provide further value to customers. A number of retailers - not just supermarkets - offer loyalty programs.
- **In-store experience:** Investing in store layout and amenities enhances the in-store shopping experience. Factors such as cleanliness, organisation, and staff friendliness contribute to overall customer satisfaction and loyalty. Both Woolworths and Coles offer a 'quiet hour' for customers with sensory needs.

As noted, access to a range of offerings remains important, with a wide variety of choices for consumers as to where they can buy their food and groceries including:

- Major supermarkets such as Woolworths, Coles, Aldi and Costco;
- Local and community supermarkets such as IGA, Spudshed and Drakes;
- Australian grocery chains like Harris Farm;
- Small businesses like local bakeries, butchers and greengrocers;
- Direct to consumer and wholesale markets;
- Meal kit delivery services; and
- Fast food, restaurants and take-away services.

These increased options are changing the make-up of the Australian retail sector. Since 2014, there has been an 8.2% contraction in the combined market share of Coles and Woolworths as Aldi, Costco and Metcash gain share and boost competition in the market, encouraging innovation and improving quality across the industry. The 2017 launch of Amazon Australia has provided further customer choice, particularly in packaged grocery and everyday needs.

The chart below highlights the increase in market share of other competitors.



Source: IBISWorld

In its 2023 submission to the House of Representatives Standing Committee on Economics Inquiry into promoting economic dynamism, the Productivity Commission wrote in relation to supermarkets:

The sector has observed aggressive competition between Australia’s two major domestic supermarkets despite the high level of concentration.

Woolworths Group has a 37% share of the market in 2021 and Coles 28%. The other two main competitors, Aldi and Metcash (which includes IGA and Foodland) had a 10% and 7% share respectively (source: Hunt Export Advice 2023). There are other competitors in the wings offering new delivery options.

Supermarkets reported that they have responded to increases in competition by limiting price increases and enhancing the ‘in-store experience’ — improving the level of customer service and increasing the range of services offered.

Two large players with a competitive fringe have provided a highly competitive market in Australia.

These data points and observations are reflective of a highly competitive sector that is becoming more competitive, with the vast majority of Australians able to choose from a range of stores in their local area and shop around for the best value and product offering. This is markedly different to the experience of Australians in other essential consumer markets like banking, insurance, energy or telecommunications - where the cost of switching is a key barrier for consumers and competition.

The key driver of higher prices for consumers is higher costs for retailers

The ARA welcomes the opportunity to participate in this Inquiry, which we believe will most likely confirm what we already know – that the cost of doing business has increased across the board in recent years; and that these higher costs along the retail value chain are key drivers of higher prices.

The same inflationary pressures impacting households are also impacting businesses, with the cost of doing business in Australia increasing across the board in recent years - including increases in wages, fuel costs, energy costs and leasing costs.

According to the Reserve Bank of Australia (RBA), these pronounced inflationary trends arise from diverse factors, encompassing supply constraints arising from geopolitical issues, the pandemic and domestic impacts from natural disasters. In navigating these pressures, supermarkets collaborate with suppliers to address challenges and minimise impacts on prices where possible.

To better understand the factors that influence retail prices, and hence overall inflation, it is imperative to examine the various costs and margins involved in the journey from suppliers to consumers. Five major cost components shape this process:

- the supplier's cost of procuring or producing goods;
- the supplier's operational costs;
- the supplier's sell price, inclusive of the supplier's profit;
- the retailer's operational costs, tax and interest obligations; and
- the retailer's net profit.

As noted, costs have increased across the board in recent years. However, our members have maintained a stable NPAT over the past five years, despite these higher costs, in support of our position that allegations of excessive or unreasonable profits are unfounded.

In FY23, Coles and Woolworths Group both reported NPAT of around 2.6%. That is to say that for every \$100 in sales, our members make an NPAT of \$2.60. Put another way, if supermarkets made no profit (which is not tenable) then the cost of the same \$100 basket would reduce to \$97.40.

It is worth noting that this \$100 also pays to keep staff employed, pays suppliers to keep their teams employed and pays for rent, energy, fuel and tax. It also helps fund reinvestment into areas of the business that contribute to community improvements, such as the development of new stores and distribution centres as well as investments into sustainability and community initiatives.

Graeme Samuel AC, Chairman of the ACCC between 2003 and 2011, who oversaw the last review of the Food and Grocery Code of Conduct in 2018, stated:

A lot of this could be resolved by looking at the annual accounts. The simplest thing to do is to look at profit margins, and are they reasonable or not? Compared with overseas, Australia is more competitive, lower profit margin, and pricing.

To reaffirm our position, the ARA believes that higher prices are due to higher costs not higher profits.

The data suggests that SA policy settings are adversely impacting SA consumers

The ARA has analysed the trends and factors influencing grocery prices in SA compared to other states in Australia. Despite efforts to promote competition and support smaller independent stores, recent data suggests that the competition practices in place are not effectively controlling rising prices, with SA consumers experiencing a notable increase in grocery prices according to ABS data.

One significant factor contributing to this trend is the impact of regulatory frameworks on market competition in SA. While initiatives such as encouraging consumers to buy local products aim to support SA businesses, the effectiveness of such campaigns in influencing pricing dynamics remains questionable. Despite commendable

efforts to promote local purchasing, including the recent 'Buy SA. For SA.' campaign, grocery prices in SA have continued to rise at a higher rate compared to other states.

The regulation of retail trading hours in SA also presents challenges, with preferential treatment towards smaller independent stores, while imposing constraints on larger supermarkets. While smaller independent retailers benefit from the flexibility to trade extended hours, larger businesses operating in the CBD and suburbs face closure by 5:00 pm on Saturdays, alongside restrictions in regional communities and on public holidays.

Despite (or maybe because of) the competitive advantage conferred upon smaller traders through these regulatory exemptions, grocery prices in SA have increased by 16.4% in Adelaide between 2021 and 2023, outpacing the increases observed in Melbourne (16%) and Sydney (14.8%), as per ABS data.

In terms of any discrepancy between metropolitan and regional communities, we note that metropolitan areas typically have a higher density of supermarkets and in most inner-city areas consumers can access a greater range of options close to home. The ability to expand and compete in metropolitan areas provides our members with capital to invest in regional and rural areas, bringing job security and food security to local communities.

During the Tasmanian hearing of the Select Senate Committee into Supermarket Prices, we note Ms Tania Hunt, Chief Executive Officer, Youth Network of Tasmania made the following remarks in regards to competition and the cost of groceries in regional Tasmania:

“...that there is less competition, and they tend to be smaller supermarkets, or an IGA, for example. Some of those rural and remote communities don't have Woolworths or Coles or larger supermarket chains in their communities.

“Essentially these challenges are further exacerbated for young people living in rural and remote communities. We've heard from young people that the price of supermarket groceries can be up to 50 per cent more expensive than in metro areas.”

The Food and Grocery Code of Conduct remains the best mechanism for managing disputes between retailers and suppliers

Maintaining robust trade partnerships is a cornerstone of our members' commitment to ensuring optimal outcomes for both customers and suppliers. Despite the fluctuation in product prices, various associated costs persistently remain high, encompassing transport, processing, packaging, labor, and operational expenditures.

The Food and Grocery Code of Conduct serves as the current mechanism to address disputes arising from these and other pressures, providing suppliers the means to independently and confidentially address concerns related to retailers. With the Code sunsetting on 1 April 2025, a review of the Code is required to determine whether it remains fit for purpose.

The ARA notes the Hon Dr Craig Emerson MP has been appointed to undertake this review of the Code, supported by a secretariat within Treasury. The review will:

- Assess the effectiveness of the Code provisions in achieving the purpose of the Code to improve the commercial relationship between retailers, wholesalers and suppliers in the grocery sector, and
- the need for the Code, including whether it should be remade, amended or repealed.

Our members look forward to participating and contributing to this review.

As proud founding signatories bound by the Code, Coles and Woolworths offer multiple avenues for dispute resolution, empowering suppliers to seek resolution directly, engage a Code Arbiter, request Independent Reviewer intervention, opt for mediation or arbitration, or seek independent legal advice.

The Code Arbiter, appointed by grocery retailers and wholesalers, diligently investigates and proposes resolutions while ensuring confidentiality and promoting fair dealings. An annual report, publicly accessible on retailers' websites, details the complaints received and resolved. Upholding confidentiality, the Code Arbiter guards the supplier's identity unless explicit consent is provided. Dissatisfied suppliers can call upon the Independent Reviewer to assess the Code Arbiter's process.

The recent annual report by Independent Reviewer Chris Leptos revealed no formal complaints from food and grocery suppliers against Woolworths and Coles in 2023. In parallel, both members proactively foster supplier relations through an in-house complaint process, reinforcing an environment of open communication.

Graeme Samuel AC remarked the Code has largely worked, with improved relationships between retailers and suppliers, complaints resolved by an independent arbiter, and a culture of fair dealings between our members and suppliers.

The ARA also notes the Treasurer has directed the ACCC to hold a price inquiry into the markets for the supply of groceries. Importantly, the ACCC has been directed to look at the structure of grocery markets, including competition at the supplier, wholesaler and retailer levels. The emphasis on reviewing the entire grocery supply chain, not just the retail segment at the end, is welcome. Our members look forward to assisting the ACCC.

The evolution of online shopping and other mechanisms has created transparency in pricing without the need for regulation

The ARA recognises the importance of transparency in the supermarket sector for the benefit of both consumers and producers. While transparency is crucial for fostering trust and fairness in the marketplace, implementing initiatives such as pricing panels - a suggestion from the Australian Council of Trade Unions - presents significant challenges due to the diverse range of products held in supermarkets.

Pricing panels, while theoretically promising, may encounter practical difficulties when applied to supermarkets. Unlike industries with more standardised products, supermarkets stock a vast array of items, ranging from fresh produce to packaged goods and household essentials. Each of these products may have varying cost structures, sourcing methods and price dynamics, making it challenging to create a standardised pricing panel that accurately reflects market conditions across all product categories.

Moreover, the dynamic nature of retail pricing adds another layer of complexity. Prices in the supermarket sector can fluctuate frequently due to factors such as changes in supply chain costs, seasonal demand and promotional activities. Implementing pricing panels that accurately capture these fluctuations in real-time would require sophisticated data collection and monitoring systems, which may not be feasible for all retailers, especially smaller operators.

Our position is that other measures, already in place, provide pricing transparency to consumers, without the need for regulatory intervention.

Many of our members offer both online and in-store sales channels, allowing consumers to compare prices and offers from home before making a purchase. By investing in user-friendly digital platforms and price comparison tools, retailers can empower consumers to make informed purchasing decisions while promoting healthy competition in the marketplace.

Furthermore, our members have invested in developing robust online propositions and digital tools to enhance the shopping experience and assist customers. These digital tools include features designed to empower customers, such as:

- **Cumulative spend tracking:** Customers can track their total spend in real-time as they add products to their online cart, enabling them to adjust their selections to align with their budgetary constraints.
- **Digital shopping lists:** Before visiting the store, customers can prepare their shopping lists digitally, incorporating specials, seasonal discounts, and ongoing low prices, thereby streamlining their in-store shopping experience.
- **Best unit price tool:** Our members offer a "best unit price" tool, which ranks products based on their price per unit, allowing customers to identify the most cost-effective options effortlessly.
- **Comprehensive specials listings:** Customers have access to a comprehensive database of weekly specials, extending beyond those featured in printed or digital catalogues, enabling them to maximise savings on their purchases.

Through these innovative digital tools, our members provide customers with greater transparency during their shopping experience, facilitating informed decision-making and enhancing overall satisfaction.

CONCLUSION

The Australian grocery sector is highly competitive and assertions made that high prices are due to low levels of competition are not accurate. Nor are claims that higher prices are due to higher profits.

There are multifaceted factors contributing to higher prices, including higher costs of doing business with specific reference to labour costs, energy and fuel costs, leasing costs and insurance costs, which impact retailers directly and indirectly through their supply chain partners.

In our Pre-budget Submission, the ARA made a number of recommendations to address these challenges and their impact on the retail value chain.

In navigating the complex grocery sector landscape, the ARA urges regulators and policymakers to consider the holistic view of the supply chain, the impact of global factors on prices and the continual need for innovation and efficiency.

Regulatory oversight in this sector must be mindful of the complex market dynamics in order to foster a competitive and transparent grocery sector in Australia that remains adaptive to the changing needs of Australian consumers.

Thank you again for the opportunity to provide a submission on the proposed amendments to the Senate Select Committee on Supermarket Prices. Any queries in relation to this submission can be directed to our policy team at policy@retail.org.au.