

ARA SUBMISSION

SENATE SELECT COMMITTEE ON SUPERMARKET PRICES

FEBRUARY 2024

The Australian Retailers Association (ARA) welcomes the opportunity to provide comments on the Senate Select Committee on Supermarket Prices.

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 in all states and across all categories - from food to fashion, hairdressing to hardware, and everything in between.

Specifically, we are proud to represent Australia's two largest supermarket groups and we look forward to highlighting the positive ways in which they 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 in the sector for the benefit of Australian consumers.

These new entrants have entered the market at a time when the growth of on-line shopping and extended trading hours have increased choice for consumers, and investment in technology has reduced the underlying costs of operating a supermarket business - savings which have mostly been passed onto consumers.

However, these improvements for consumers have coincided with significant increases in the cost of doing business resulting from the pandemic, global conflict and natural disasters and subsequent economic challenges that have increased fuel costs, energy costs, labour costs, rent and outgoings, and insurance costs.

There are currently eight inquiries across the country on - or involving - Australia's largest supermarkets, in addition to the Food and Grocery Code review.

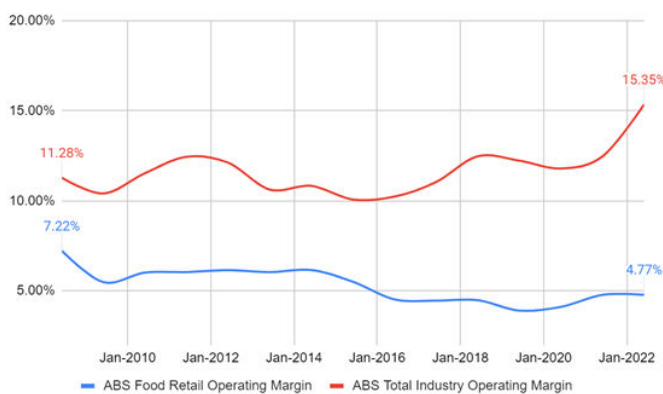
The primary claim against supermarkets in these inquiries is that they have failed to pass on lower costs to consumers through lower prices, resulting in an unacceptable level of profitability.

On behalf of our members Coles and Woolworths, we reject that claim. Analysis of Financial Statements for the five years up to the FY23 reporting period confirms that combined payments to suppliers have increased at a faster rate than the combined increase in sales. At the same time, combined Net Profit After Tax (NPAT) has increased at a much slower rate than either sales or costs in the past five years.

The secondary claim is that Australia’s supermarket sector has become less competitive in recent years, resulting in higher prices and higher profits. We also reject that claim.

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 for consumers and diluting market share for Woolworths and Coles.

These competitive forces have also put downward pressure on profits for Australian supermarket, 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 comes in contrast with the increase in Operating Margins across the broader economy over the same period.



Source: ABS Food Retailing Operating Margins

ARA POSITION

Working with our members, the ARA welcomes the opportunity to participate in the inquiry. However, our opening position is that this inquiry and others 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 the key drivers of higher prices.

According to the Reserve Bank of Australia (RBA), the pronounced inflationary trends from diverse factors, encompassing supply constraints arising geopolitical issues, the COVID-19 pandemic and domestic impacts from natural disasters. In navigating these pressures, supermarkets collaborate with suppliers to address challenges and minimise any impact on prices.

Profit margins for Australian supermarkets are comparable with leading global grocery retailers in Canada, UK and USA. Like Canada, the UK and USA, Australian supermarkets operate in highly competitive markets.

In FY23, Coles and Woolworths both of reported NPAT of around 2.6%. That is to say that for every \$100 that goes through the checkout at of our members, supermarkets make net profit after tax of \$2.60. Put another way, if supermarkets made no profit (which is not tenable) then the same \$100 basket would reduce marginally to \$97.40. There are many cost drivers right along the food and grocery supply chain that need to be properly considered and examined in this inquiry.

It is worth noting that \$100 pays for keeping 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, investments into social impact areas and sustainability initiatives.

The ARA further notes that late last year the Australian Taxation Office's ninth corporate tax transparency report highlighted that more than 800 large companies paid no tax in 2021-22. We are proud that both Woolworths and Coles contribute significantly to Australia's economy and are in the top 100 taxpayers.

Putting consumers first when it comes to providing value on everyday essentials should be a priority. Since 2014 there has been an 8.2% contraction in the joint market share of Coles and Woolworths driven by the growing market share of ALDI, and new entrants to the market, including Amazon who are growing rapidly. The ARA notes this inquiry does not include other foreign-based food retailers.

Australians are either a customer, team member, supplier or shareholder of our members, with many struggling with the increase cost of living, including extra costs from the 13-interest rate increases since May 2022. That is why our members remain committed to helping Australians eat fresh produce at affordable prices.

ARA RESPONSE TO TERMS OF REFERENCE

The ARA makes the following observations and recommendations in response the committees' terms of reference.

Driving value and competition in the Australian food retail sector

Our members strive to negotiate mutually beneficial commercial arrangements with suppliers that often lead to cost savings that can be passed on to consumers. Consumers are savvy and have high expectations of retailers in terms of value, choice and convenience.

Consumers have many choices as to where they can buy their food and groceries including:

- Major supermarkets including Woolworths, Coles, Aldi and Costco;
- Local and community supermarkets such as IGA;
- 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

The vast majority of Australians can choose from a range of stores in their local area and the barriers to switching grocery retailers are very low. This is markedly different to the experience of Australians in other essential consumer markets like banking, insurance energy or telecommunications. Price is one of the top drivers of consumer choice and this drives intense competition between grocery retailers.

This availability of choice for consumers dispels the assertion that there is not enough competition which drives higher prices at the checkout.

Since 2014 there has been an 8.2% contraction in the joint market share of Coles and Woolworths as Aldi, Costco and IGA gain share and boosting 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.

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.

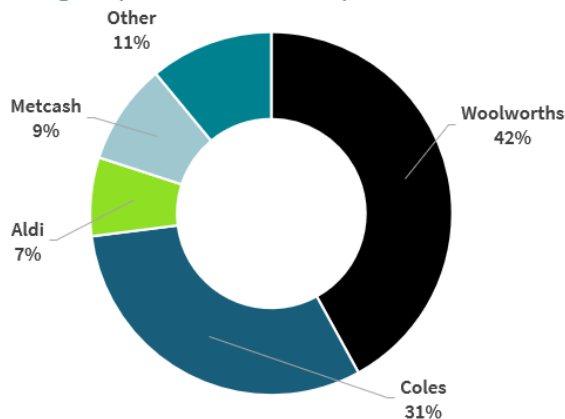
Woolworths Group has a 37% share of the market in 2021 and Coles 28%. The other two main competitors, Aldi and Metcash (which includes IGA and Foodland) had a 10% and 7% share respectively (source: Hunt Export Advice 2023). There are other competitors in the wings offering new delivery options.

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.

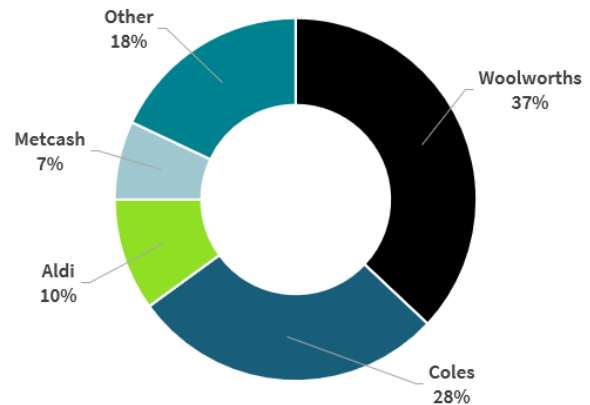
Two large players with a competitive fringe have provided a highly competitive market in Australia.

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

Food and grocery sector market share September 2014



Food and grocery sector market share for the financial year 2022-23



Source: IBISWorld

Our members’ NPAT has remained largely stable over the last five years with minor variation year on year. Profit moderated in the peak inflationary environment, demonstrating that increasing supermarket price increases reflected increasing supplier costs and costs of doing business.

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

Fostering fair and competitive prices in Australian supermarkets

Australian supermarkets operate within a comprehensive regulatory landscape that spans food safety, workplace health and safety, industrial relations, and customer-supplier interactions.

The competition and consumer regulatory framework, leading globally, includes pioneering measures like the Grocery Code of Conduct and unit pricing, setting Australia ahead of international jurisdictions.

Voluntarily entered into by the supermarkets, the Food and Grocery Code of Conduct governs relationships between signatories and suppliers, with our members being inaugural supermarket signatories in 2015, showcasing a steadfast commitment to equitable practices.

Enforced by the ACCC, they are bound by the code which highlights their dedication to fair dealings in the industry. The code is scheduled to sunset on 1 April 2025. Prior to sunsetting, a review of the code is required to determine whether the code 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
- Consider the need for the code, including whether it should be remade, amended or repealed.

Promoting economic growth and consumer choice: the positive impact of prices for everyday essentials

Over the past five years, our members have maintained a stable NPAT, demonstrating resilience amidst fluctuations in costs and prices, and challenging the assertion of price gauging. Consistent financial performance allows for stability for these important community employers and providers. This creates certainty in employment and stability ensuring all Australians have access to essential items.

As noted, if supermarkets made zero profits grocery prices would come down by 2.6% (in-line with NPAT) equating to a \$2.60 reduction in a \$100 basket of goods.

A profitable business allows our members to continually adjust their operations and strategies to keep up with consumer needs and expectations. For supermarkets, sustainable profits have underpinned multi-billion investments in new distribution centres, which are key to boosting supply chain resilience and food security across Australia.

Our members' profits did not dramatically rise in Y23 if you compared to the last five years Y23 was stable and reflective of a billion-dollar operation.

The global economic landscape has experienced a dramatic shift, resulting in customers prioritising value, to address concerns about living costs. Increasing expenses, from mortgage and rental payments to higher electricity and fuel prices, are exerting pressure on household budgets. Although our members cannot directly influence these mounting costs, they actively contribute to supporting Australian families by delivering value across their product range.

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

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

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 a more competitive, lower profit margin, and pricing

Profits are primarily used to either invest in improving the customer experience of their members, or to pay dividends to shareholders, the overwhelming majority of who are mums, dads, families and retirees.

Enhancing transparency and value

Demonstrating a commitment to providing exceptional value, our members have maintained a longstanding tradition of delivering savings to customers through a variety of promotional strategies and taken proactive steps to address consumer concerns and foster transparency.

This includes weekly specials on thousands of everyday products, enticing multi-buy/mix and save options that activate discounts with the purchase of more than one product, seasonal specials, strategic markdowns, engaging promotional campaigns, and festive sales during Christmas and Easter.

In August 2022, Coles locked the prices of 1,100 products for five months, setting a precedent for price stability. Subsequently, in October 2022, January 2023, and June 2023, Coles intensified its commitment by dropping and locking the prices of 150, 300, and 480 items, respectively.

Woolworths implemented a strategy in the lead-up to Christmas 2022 by initiating a six-month price freeze on 200 grocery essentials. This was complemented by the launch of four seasonal campaigns and a dedicated Christmas Prices Dropped initiative, all aimed at providing customers with genuine value and countering the perception of opportunistic pricing practices.

Both supermarkets reduced the price of Christmas hams in 2023 to \$8 per kilo, the lowest in four years, enabling customers to celebrate the festive season with family and friends cost effectively. In the lead up to Christmas Woolworths reduced the price of lamb by 20%.

Our members also offer an array of loyalty programs providing their customers with the opportunity to make even further savings. Coles' Flybuys loyalty program reaches approximately 80% of all Australian households helping customers to save money through individual offers, earning rewards on every dollar they spend in our supermarkets and liquor stores and by collecting points through our network of partners.

Woolworths Everyday Rewards program offers customers to receive a point for every dollar they spend, the points can then be used to save on future shops or converted to Qantas points. It also provides customers exclusive specials.

As our members engage in competitive pricing strategies, customers stand to benefit from the assurance that prices are not just marked down but are genuinely reflective of their commitment to affordability and value. The introduction of these comprehensive pricing initiatives reaffirms the supermarkets' dedication to ensuring that their pricing practices align with consumer expectations and transparency standards in the retail sector.

Offering choice and value through home brand products

The ARA understands consumers are looking for great value on everyday essentials and our members seek to provide low pricing on the products they sell.

Globally, retailer private labels have continued to evolve from being a low-spec and cheap alternative to proprietary brands, to becoming multi-faceted strategic differentiators with more sophisticated offers.

Responding to cost-of-living pressures, to support the consumers search for value and affordability both members have launched their own and exclusive brands for essential items. Home brand products can retail at an average price of less than 30% below the branded equivalents.

The lower price is typically achieved by the retailer taking a lower margin on these products to offer affordable entry level options.

Home brand products are popular and their appeal has risen as cost-of-living pressures have increased. They provide consumers with more choice and value to suit their needs.

Investing in customer experience and convenience

Our members are investing in cutting-edge technology to elevate customer convenience and employee safety. As in-store visits return to pre-COVID levels, our members are focused on boosting customer mobility and accessibility.

With both members, their store's features are based on the needs of the local community including enhancing store layouts for a better customer experience. Woolworths implemented low-sensory quiet hours in over 900 stores, easing anxiety and sensory stress for customers with specific needs, including autism.

The digital era has ushered in a surge in online shopping, with a pronounced demand for express delivery options like same-day and on-demand within the hour. Responding to this trend, Woolworths made changes to the Woolworths and Everyday Rewards apps and websites to make it easier for customers to shop online including in remote and regional areas.

Since 2018, Coles has been working with international technology firms Witron and Ocado to deliver advanced distribution centres in their supply chain network and in support of their online delivery business to build speed and efficiency in their operations and enhancing customer experience with better availability, selection and convenience.

Both members have experienced elevated levels of organised retail crime and customer aggression in their stores. In response they have invested in technology to help manage these risks to the team members, customers, and operations. They have also invested deeply in mental health, wellbeing and training for their teams.

Additionally, there has been an increased security presence in stores along with new body worn cameras being rolled out to ensure staff are safe as we have seen a rise in aggressive behaviour from some customers.

Our members are shaping tomorrow's retail experience with a focus on efficiency, innovation, and unparalleled customer service through new technology.

Improving the regulatory framework

As noted, the Food and Grocery Code of Conduct is scheduled to sunset on 1 April 2025. Prior to sunset, a review of the code is required to determine whether the code 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.

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.

Resolving disputes with 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, providing suppliers the means to independently and confidentially address concerns related to retailers.

As proud founding signatories bound by the Code, our members 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, 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 review 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 in-house complaint units, reinforcing an environment of open communication.

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

The Food and Grocery Code of Conduct has played a pivotal role in fortifying supplier-retailer relationships, with both members committed to ongoing enhancement.

Looking at the impact of multinational food companies on price inflation in Australia

Our members confront a unique challenge as they navigate strategic decisions involved in managing cost pressures from global food suppliers. Some of these suppliers are much larger than Woolworths and Coles and over the past two years have requested significant cost increases well above headline inflation.

The key reason provided by suppliers - to support these requests - was that they had incurred cost increases in relation to the following items: labour, wheat, packaging, utilities, freight and international shipping.

Most of what consumers pay at the checkout goes to a supplier and, in the Australian context, a significant portion of these supplier payments go to multinational food companies. So, we welcome an examination of the role that these large, global food suppliers play in applying inflationary pressure to grocery prices.

Indeed, regulators in other markets are increasingly turning their minds to these supply chain issues. In November 2023, the UK's Competition and Markets Authority (CMA) published findings from an in-depth study of supplier margins across a range of essential product categories. The CMA found that over the last two years, around three-quarters of branded suppliers had increased their unit profitability and, in doing so, contributed to higher food price inflation.

This higher unit profitability flows through to higher NPAT for these suppliers, who enjoy higher profit margins than Australian supermarkets. The chart below illustrates that the NPAT for five multinational food companies supplying to Australian supermarkets. These higher supply chain profit margins are included in prices paid by Australian consumers.



CONCLUSION

The Australian grocery sector is complex and requires a balanced approach between regulatory scrutiny and recognising the efficiencies that contribute to competitive pricing, enhanced consumer choice and convenience.

There are multifaceted factors contributing to higher prices, including energy, labor, logistics and taxation. In our [Pre-budget Submission](#), the ARA made a number of recommendations to address these challenges and their impact on the retail value chain, including the appointment of a National Supply Chain Commissioner to increase accountability in government for supply chain challenges.

Furthermore, the ARA highlights the commitment of its members, Coles and Woolworths, to transparency, customer value, and innovation through their initiatives such as price freezes, loyalty programs, and the introduction of home brand products, emphasising their role in providing consumers with affordable options.

In navigating the intricate landscape of the grocery sector, the ARA urges 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.

Balancing regulatory oversight with a recognition of market dynamics and consumer needs is deemed essential for fostering a competitive, transparent, and consumer-friendly supermarket environment in Australia.

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.