



30 April 2024

Australian Competition and Consumer Commission
23 Marcus Clarke Street
Canberra ACT 2601

Via email: supermarkets@acc.gov.au

Dear Sir/Madam,

Submission to the Supermarkets Inquiry 2024 -25

The ACCC's Supermarkets Inquiry (the Inquiry) is an important opportunity to identify and analyse the reasons for poor market outcomes in the supermarket sector and to develop solutions that will deliver enduring benefits for Australian consumers and small businesses. It is critical that the ACCC takes full advantage of its inquiry powers to expose the nature of business practices and competitive dynamics in this sector and demonstrate their impacts on different types of market participants. Only then can the sources and harms of market power in this sector be fully understood and reforms proposed to address them.

The Inquiry takes place against a backdrop of parliamentary and government scrutiny into the supermarket sector, particularly Woolworths and Coles (the major supermarkets). This scrutiny is justified, because the major supermarkets' entrenched market power has enabled them to deter the entry of new competitors to the detriment of Australian consumers and small businesses. This is despite previous attempts to enhance competition (like the ACCC's Grocery Inquiry) and improve standards of business behaviour (notably the introduction of the Food and Grocery Code of Conduct).

The Inquiry is a rare opportunity to holistically examine the nature of competition in the grocery supply chain and to inform policymakers' understanding of the second and third-order effects that arise from the market power of the major supermarkets. This is important to ensure that the major supermarkets cannot simply transfer the compliance costs of reforms across the supply chain to those already inefficiently overburdened. The ACCC must gain a strong understanding of how the major supermarkets make decisions, both in terms of their inputs and processes, as well as how those decisions impact on supply-chain participants and the broader economy.

Small businesses are a crucial part of this story. Small businesses account for 78% of the value of production by the agriculture, forestry and fishing sector and employ 79% of its workers.¹ Small businesses are themselves consumers and employ consumers in this sector. It is therefore critical that, when examining issues and possible solutions in the Inquiry, the ACCC considers how they may impact small business interests and incentives. The broad scope of the Inquiry means that the ACCC is not limited to taking a narrow, consumer-welfare approach to its analysis.

This submission aims to assist the Inquiry by suggesting avenues of inquiry and approaches to ensure that the policy reforms that result from the Inquiry and other ongoing processes address

¹ Australian Small Business and Family Enterprise Ombudsman (ASBFEO), *Contribution to Australian Gross Domestic Product*, ASBFEO, Australian Government, June 2023, p. 4, and ASBFEO, *Contribution to Australian Employment*, ASBFEO, Australian Government, June 2023, p. 4.



key issues and are effective in delivering widespread benefits across the supply chain. The ASBFEO is available for further consultation to assist the Inquiry.

Recommendation 1: The ACCC should closely investigate the nature and effects of bargaining power imbalances affecting small businesses in the grocery supply chain and consider suitable solutions to achieve efficient and equitable outcomes.

The ACCC should use its inquiry powers to examine and report on the nature and significance of bargaining power imbalances affecting small businesses in the grocery supply chain. In doing so, the ACCC should examine the decision-making inputs and processes of the major supermarkets, to uncover the rationales and incentives that underlie the commercial dealings they have with their suppliers. The ACCC should also explore whether there should be stronger safeguards in place to protect the interests of small suppliers to enhance competition and promote new entry.

A useful avenue of inquiry for the ACCC to examine these issues may be the supply arrangements between fresh produce suppliers (most of which are small businesses) and major supermarkets. Perhaps more so than many other types of suppliers, fresh produce suppliers have a substantial bargaining power disadvantage with the major supermarkets.² This is due to multiple reasons, including their relative lack of resourcing, the perishability of fresh produce, the difficulty for end consumers to differentiate quality at the point of purchase, and the practice of fresh produce being sold as (in effect) private label products by supermarkets. The ASBFEO has also heard that most fresh produce suppliers lack the means to export due to shelf life, logistical cost and market access constraints and are therefore reliant on domestic buyers.

As a result, supply arrangements between fresh produce suppliers and major supermarkets include many entrenched practices that demonstrate how major supermarkets exploit their buyer power at significant cost to broader economic efficiency and the welfare of small suppliers.

Two examples of such practices that the ASBFEO has heard from its stakeholders include:

1. Distortionary purchasing practices and exploitation of information asymmetries

The ASBFEO understands that, as part of their supply arrangements with fresh produce suppliers, major supermarkets generally set an indicative purchase volume in advance without any binding commitment to purchase this volume or at any specified price.

This practice may create a significant bargaining power imbalance where a fresh produce supplier, because it must commit significantly earlier by, for example, preparing fields and planting crops, is subject to the discretion of a major supermarket which can later decide whether consumer and market trends warrant the purchase of the full contracted volume. Further, because the goods are perishable and, where an oversupply occurs, it usually is not limited to a local region, suppliers often do not have a realistic or favourable alternative of seeking other buyers if they are told the full contracted volume is not needed.

This bargaining power imbalance is exacerbated because major supermarkets can exploit their informational advantage over fresh produce suppliers. Major supermarkets can track

² This is supported by the Independent Reviewer's findings that fruit and vegetable suppliers reported less favourable treatment by supermarkets than other types of suppliers, particularly when answering whether supermarkets dealt in good faith and whether they dealt fairly and reasonably. Food and Grocery Code Independent Reviewer (Independent Reviewer), *2022-23 Annual Report*, The Treasury, Australian Government, 2023, p. 13.



customer data across relevant stores and interpret and forecast customer trends at multiple levels of specificity. They similarly have awareness of their contracted purchase amounts over time across their portfolio of suppliers. This gives significant advantages to major supermarkets for predicting their purchasing needs ahead of time, whereas particularly smaller and less resourced suppliers are less able to predict market trends and adjust their production accordingly.

Given industry feedback that the fresh produce wholesale markets are often oversupplied, the ASBFEO also considers it is possible that the major supermarkets exploit their various advantages to cause a structural oversupply of fresh produce. By setting larger-than-expected indicative purchase volumes and exploiting suppliers' lack of knowledge as to total contracted purchase volumes, major supermarkets may be able to manage their short-and medium-term supply risk by ensuring that fresh produce is constantly oversupplied. This would help ensure that the major supermarkets get their demanded volume of fresh produce while maintaining downward pressure on purchase prices.

To the extent that major supermarkets engage in this practice, they may lack clear or compelling incentives to moderate it, as entrenched information asymmetries could mean that fresh produce suppliers would continue to bear the cost of this market failure. Even if some fresh produce suppliers exit (accompanied by the creation of stranded assets), they would likely be replaced by unknowing and fragmented future entrants.

2. Excessive payment times

The ASBFEO understands that default payment times for supply arrangements with the major supermarkets can be up to 90 days, and that nearly all fresh produce suppliers pay rebates to major supermarkets in exchange for shorter payment times. The ASBFEO has heard that the sizes of these rebates are commonly 2.5% to 5% of the sale price, which likely far exceeds the cost to the major supermarkets of paying their suppliers earlier.

The ASBFEO considers these practices highly concerning. The almost universal use of rebates suggests that they are not in practice discretionary for fresh produce suppliers. Whether this is because fresh produce suppliers cannot maintain their needed cashflow with the default payment times, or because they do not consider that they have a choice, it likely means that rebates have become part of the major supermarkets' decisions on purchase prices. Accordingly, the use of rebates likely impedes price transparency for suppliers and may not be a genuine cost to the major supermarkets for shorter payment times.

Even if the use of rebates is a genuine response to shorter payment times, if their size exceeds the cost to the major supermarkets of paying their suppliers earlier, then it suggests that fresh produce suppliers are bearing a disproportionate part of the solvency and liquidity risks of the major supermarkets despite them being less able to bear such risks.

The ASBFEO has also heard other concerns from industry stakeholders, including about distribution arrangements and unscheduled promotions. When examined together, the ASBFEO considers that these practices and the above examples are highly distortionary, as they exploit the major supermarkets' market power and informational advantages to shift a disproportionate amount of risk and costs onto fresh produce suppliers. This places significant strains on their cashflow and solvency, and undermines their ability to withstand other risks, including climate risks and input-cost volatility.



This is particularly concerning because market forces and regulation have historically been unable to rectify these possible inefficiencies, and there are no clear incentives for major supermarkets to moderate their behaviour. If unaddressed, these issues may drive an inefficient exit and new entry of suppliers with repeated creation of stranded assets and otherwise unneeded start-up costs. These issues may also decrease consumer welfare in the form of reduced choice for fresh produce, and lower spending power for consumers, to the extent they are employed by (or otherwise financially dependent on) the ability of Australian fresh produce suppliers to compete.

Recommendation 2: If the ACCC uncovers entrenched practices of significant concern, it should consider whether continued scrutiny and monitoring of the sector is appropriate.

As set out in recommendation 1, the ASBFEO considers that there are multiple entrenched practices of concern in the fresh produce supply chain. The ASBFEO considers that these practices demonstrate broader problems in the supermarket sector that include, for example, the market power of the major supermarkets and the effects this has on the incentives and constraints (or lack thereof) guiding their decision-making.

The Independent Reviewer's findings illustrate both the importance to suppliers of having a supply relationship with a major supermarket, as well as the weak bargaining position that this puts them in. This 2022-23 annual report finds that more than 41% of surveyed Woolworths and Coles suppliers reported 'fear of damaging a commercial relationship' as an impediment for raising an issue with the supermarket, compared to 21% and 28% of surveyed ALDI and Metcash suppliers.³ This likely reflects how much more difficult it is for a supplier to replace a supply relationship with a major supermarket than it is for a major supermarket to replace a supplier.

The Independent Reviewer also uncovers significant disparity between supermarkets in terms of how accessible it is for suppliers to negotiate better prices with their supermarket. More than 50% of surveyed Woolworths and Coles suppliers reported finding price negotiations to be 'involved' or 'challenging', compared to 39% and 24% of surveyed ALDI and Metcash suppliers respectively.⁴

Given the buyer power of the major supermarkets in the food and grocery wholesale markets, if the ACCC's findings verify the ASBFEO's concerns or if the ACCC uncovers other entrenched practices of significant concern, the ACCC should consider whether the supermarket sector should be subject to continued scrutiny and monitoring. This could be in the form of an ACCC monitoring inquiry, as has been adopted in the electricity, gas and airline markets respectively. This can enhance the public accountability of the supermarket sector and inform policymaking to promote efficiency and good market outcomes in grocery supply chains.

Recommendation 3: The ACCC should engage with other relevant inquiries and reviews to ensure that adequate safeguards are introduced to protect consumers and small businesses from harmful conduct and market outcomes in the supermarket sector.

As the ACCC is aware, there are a range of other recent and ongoing inquiries and reviews relating to the supermarket sector.⁵ The ACCC should engage with these other processes to share lessons

³ Independent Reviewer, *2022-23 Annual Report*, The Treasury, Australian Government, 2023, p. 18.

⁴ Independent Reviewer, *2022-23 Annual Report*, Food and Grocery Code Independent Reviewer website, Australian Government, 2023, accessed 26 April 2024.

⁵ These include, for example, the inquiry by the Senate Select Committee on Supermarket Prices, the Food and Grocery Code of Conduct Review 2023-24 by Dr Craig Emerson, the annual reports of the Independent Reviewer appointed under the Code, and multiple state-led inquiries.



and develop coordinated responses to address the policy concerns relating to this sector. At a minimum, this coordinated action should include a comprehensive identification of harmful conducts and poor market outcomes, and the development of safeguards (for example, minimum standards in grocery supply agreements) to mitigate their effects.

The ASBFEO considers that a critical part of the policy response is the strengthening of the Food and Grocery Code of Conduct (the Code) so that it sets meaningful standards that better allocate risks and costs in the grocery supply chain and facilitates effective ACCC enforcement that can credibly deter parties from misconduct. Penalties and supplier remediation for breaching the Code should be proportionate and targeted.

While an improved Code cannot by itself solve poor competition or market outcomes, it should be designed to alleviate their most damaging effects. This will likely require close cooperation between the ongoing inquiry and review processes, and the ASBFEO strongly encourages the ACCC to share its expertise and inquiry findings to inform the improvement of the Code.

Further comments: Dispute resolution and code enforcement through the court system

Alternative dispute resolution, including under the Code, can provide a cost efficient and timely avenue of dispute resolution. However, where disputes cannot be resolved through alternative dispute resolution, small businesses can face significant financial and time costs to seek redress through litigation, as well as the risk of adverse cost orders. Accordingly, harmed businesses tend to rely upon regulator-led remedies, yet often find that their circumstances do not trigger the policy parameters for enforcement action.

The ASBFEO therefore advocates for the introduction of a Small Business and Codes List in the Federal Circuit Court and Family Court of Australia. This would provide small businesses with a timely means to directly pursue their commercial interests and receive a determinative outcome. The knowledge that an accessible means of formal dispute resolution exists can also incentivise parties to resolve disputes early, thereby enhancing the effectiveness of the Code.

The size of disputes appearing on the list could be capped, the parties could be required to bear their own costs and court processes including alternative dispute resolution could be delivered via online hearings, significantly reducing the time and cost burden on a small business.

If you would like to discuss this matter further or require any further information, please contact the ASBFEO via email at advocacy@asbfeo.gov.au.

Yours sincerely

The Hon Bruce Billson

Australian Small Business and Family Enterprise Ombudsman