

Australia's retail food sector

Some preliminary observations

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The Australian retail food sector has been changing over recent decades, affecting consumers, producers and trade. Many of the changes have increased the efficiency of different aspects of the retail food sector. Shifts in market power and industry concentration in food retailing could also have an influence on further capturing the potential efficiencies in this sector.

Acknowledgments

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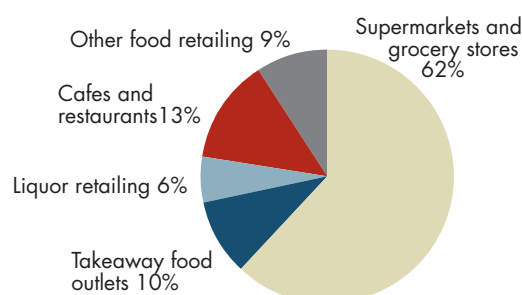
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Introduction

The Australian Government Department of Agriculture, Fisheries and Forestry (2005) reported that total Australian retailing in 2003-04 was valued at A\$193.3 billion. In the same year, total Australian food and liquor retailing was valued at A\$88.7 billion, roughly 46 per cent of total retail trade. Retail trade in supermarkets and grocery stores in 2003-04 was valued at A\$55.1 billion, which accounted for 62 per cent of total food and liquor retailing (figure A and table 1). Cafe and restaurant retail trade, followed by takeaway food outlet retail trade were respectively the next largest sources of Australian retail food trade. Given the significance of supermarkets and grocery stores, this paper makes some preliminary observations on the conduct and structure of the Australian supermarket industry.

A Australian retail food trade, 2003-04



1 Australian retail food trade

	2000-01	2001-02	2002-03	2003-04	Share of total food and liquor retailing 2003-04
	A\$m	A\$m	A\$m	A\$m	%
Supermarkets and grocery stores	45 191	48 617	51 686	55 136	62
Takeaway food outlets	6 844	7 229	7 744	8 556	10
Liquor retailing	3 619	3 880	4 520	5 322	6
Cafes and restaurants	9 061	9 160	9 737	11 634	13
Other food retailing	6 801	7 881	8 205	8 087	9
Total food and liquor retailing	71 515	76 767	81 891	88 735	100

Source: Department of Agriculture, Fisheries and Forestry (2005, table 4.1, p. 57).

Facts and trends in Australia's retail food sector

Supermarket and grocery store market concentration

The Australian Competition and Consumer Commission (1999) reported that the national grocery market shares of Woolworths, Coles and Franklins increased from 40 per cent in 1975 to approximately 80 per cent in 1998. In 2002, the National Association of Retail Grocers of Australia estimated that Woolworths and Coles had a combined market share of 76 per cent, based on the additional stores that the two chains acquired from the breakup of the Franklins supermarket chain. Given the Australian market share estimate and the

series of global retail food market share statistics shown in table 2, Australia has one of the most concentrated retail food sectors in the developed world. Many of the major developed countries have a relatively lower market concentration and less market dominance by any single firm.

Two firms controlling such a significant share of Australia's retail food sector indicates that the industry is a duopoly/oligopoly. Industry structures characterised as duopoly/oligopoly generally involve barriers to entry, which restricts new firms entering the industry. The incumbent firms also already possess the premium retail outlet locations and benefit from economies of scale, providing them with the ability to effectively compete with any new competitors (see Smith 2004). The incumbent firms also have large sunk costs in terms of significant investments in supply chain management and infrastructure systems. Wade and Bradley (2002) reported that Woolworths would spend \$1 billion improving its supply and distribution systems over five years. This indicates that the level of investment required for effective and cost efficient supply chain management is substantial (see Griffith 2004).

2 Global retail food market shares, 2001

	Number of firms	Market Share
		%
Australia ^a	Top 2	76
Canada	Top 5	56
Singapore	Top 5	55
Germany	Top 3	53
United Kingdom	Top 3	52
France	Top 3	44
Chinese Taipei	Top 5	40
United States	Top 5	34
Thailand	Top 5	22
Philippines	Top 5	20
Malaysia	Top 5	14
Japan	Top 5	7
Korea	Top 5	5

^a NARGA estimate for 2002.

Source: National Association of Retail Grocers of Australia (2002).

Generic house branded products: case study of fresh milk sales

One of the major trends in the past five years has been the emergence of generic house branded products, especially in fresh market milk. The Australian dairy industry was deregulated on 1 July 2000, which removed restraints on farm gate market milk prices and created a national fresh milk market (see box 1). Woolworths and Coles took the opportunity to

3 Australian supermarket milk sales

Regular whole milk

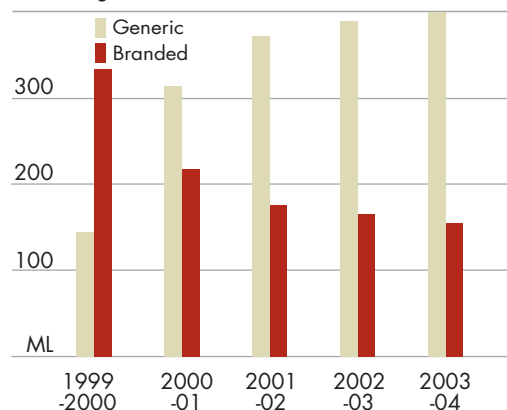
	1999-2000		2000-01		2001-02		2002-03		2003-04	
	ML	\$/L	ML	\$/L	ML	\$/L	ML	\$/L	ML	\$/L
Generic	145	1.29	313	1.05	372	1.08	389	1.12	400	1.12
Branded	333	1.33	217	1.26	176	1.35	165	1.40	155	1.42

Source: Hogan, Shaw and Berry (2004, p. 35).

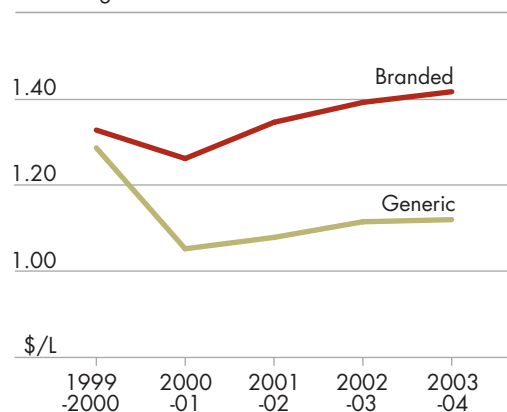
negotiate new contracts with the major processors of fresh market milk — National Foods, Dairy Farmers Cooperative and Parmalat — to supply generic house brand milk. This resulted in lower generic retail milk prices, a difference between generic and branded retail milk prices and a consumer shift from branded milk to generic milk, as shown in table 3 and figures B and C.

The Australian Competition and Consumer Commission (2001) reported that the strategy used by supermarkets was to set reduced milk prices nationally for generic label milk to attract more consumers to the stores rather than to increase milk sales revenue. This is likely to have resulted in increased competitive pressures on other retailers, such as convenience and corner stores, that sell branded products and the intangible commodity of ‘convenience’. The setting of standard national milk prices for generic

B Australian supermarket milk sales
Regular whole milk



C Australian supermarket milk prices
Regular whole milk



Box 1: Australian dairy industry deregulation

The Australian dairy industry prior to 1 July 2000 was assisted through a complex set of government regulations. Assistance was funded through the Australian Government's Domestic Market Support (DMS) scheme for manufactured milk and state-government based market milk regulations. The DMS scheme generated a monetary transfer from domestic consumers of manufactured dairy products and market milk producers to producers of manufacturing milk. Under the 1992 Crean Plan, the DMS scheme was phased out by July 2000.

The state based measures regulated supply, distribution, farm gate pricing and marketing of milk destined for fluid (or fresh) milk markets. The regulations ended in July 2000 and this reduced the disparity between farm gate prices of milk used in the fluid milk market and the milk used in manufacturing. Deregulation of the state based measures created a truly national milk market.

Deregulation changed the structure of the Australian dairy industry and exposed producers to competitive market prices. The Dairy Industry Adjustment Package was instigated to assist adjustment to the new pricing environment. It is being funded by an 11 cents a litre consumer levy over eight years. Regardless of the levy, consumers have benefited from lower retail milk prices.

Sources: Hogan, Shaw and Berry (2004); Australian Competition and Consumer Commission (2001).

label milk in 2000 by Woolworths was the first time a retail chain in Australia had set national prices for packaged milk.

Hogan, Shaw and Berry (2004) reported that the supermarket share of drinking milk sales has risen consistently in recent years and in 2003-04 represented nearly 57 per cent of total milk sales compared with just under 50 per cent in 1999-2000. Also in 1999-2000, less than 1 in every 10 litres of all milk sold was generic supermarket whole milk. In 2003-04 that figure had reached more than 1 in every 5 litres.

It is clear that the lower price has been a major factor in consumers switching to generic milk. The lower price has been caused by the competitive nature of the tendering process for generic milk contracts with supermarkets. The competitive nature of the tendering processes is only one of many factors that has altered the retail and farm gate price of fluid market milk in Australia since deregulation. Other factors include world market forces, cost of inputs (like labor, petroleum and electricity), and rationalisation of the milk processing industry, along with generic milk labeling.

Generic house branding is not isolated to drinking milk. In Australia, the major supermarket chains have indicated an intention to expand their home brand product range, which will cause changes to the availability of shelf space for national brands. Shoebridge and Whyte (2005) reported that the supermarket chains are pushing to significantly increase the number of house brand products in store. Coles has plans to lift the proportion of house branded products from 13 per cent to 30 per cent by late 2007. It has been argued that supermarkets stand to gain financially. While generic brand products sell for 5–20 per cent less than national brands, the margin that a retailer makes on a house brand is estimated to be about 2 percentage points higher than the margin earned on a national brand (Shoebridge and Whyte 2005).

The suppliers of national brands will need to decide whether they will invest large amounts of money to try to maintain existing product shelf position, or whether they will work with retailers to produce generic branded products. Shoebridge and Whyte (2005) explained that suppliers have been given the option of paying to keep some of their products on shelves. If a supplier declines to pay, they may need to ensure that a decline in branded activity is offset by house brand activity. One key issue for some products may be the lack of consumer acceptance of generic products. In the past, house branded products have only been successful for items with limited product differentiation like sugar and flour.

Consumer issues

Many Australian consumers have had an increasing disposable income over the past several decades, which has affected the retail food choices that they have made. Consumers have been able and willing to pay for higher quality foods and increased value adding. These

changes have altered the demands placed on the Australian retail food sector. Retailers have had to alter their product range to meet consumer requirements. Changes made by retailers have placed additional pressures on agricultural producers and food processors. These include more stringent quality requirements, additional processing and new product varieties.

The consumer issues of convenience and food safety have also played a prominent role in some of the changes within the retail food sector. The demand for convenience has changed the bundle of services that supermarkets have been supplying. The large supermarket chains have been able to expand and alter their product mix to satisfy the changing demands of consumers. This has involved providing alcohol related products, value added products (cooked chickens, salads, and prepared meals), petrol vouchers and photo development services. Woolworths in Australia has recently been considering expanding into the provision of pharmacy services.

The demand for convenience has resulted in ‘one stop’ shopping. Consumers are able to purchase their demanded range of goods and services in one convenient location and at nearly any time of the day. The large supermarkets have extended trading hours, which has enabled consumers to purchase their required items, in one location, at one time, without being concerned about the more limited trading hours of other specialist retailers.

Food safety concerns have also ensured that the standard of food quality and handling practices at the retail level have improved and assisted in the vertical integration of food supply chains. Food safety and quality concerns have resulted in the development of effective supply chains to deliver the high standards that consumers have demanded. Both Woolworths and Coles have extensively used supply chains to source fresh produce from agricultural producers. The development of supply chains has improved the traceability of produce and any contamination or similar food quality and safety issues can be traced back to the source or origin more efficiently.

Coupled with the food safety and quality benefits derived from the use of supply chains, the biggest driver of supply chains has been the supermarkets’ objective of achieving cost savings and efficiency gains from economies of scale and economies of scope. Large supermarket chains have the ability to benefit from large purchase volumes and can achieve lower per unit costs because of the scale of their operations. Economies of scope have been possible due to the related nature of some of the goods and services sold by supermarkets. For example, by supplying fresh chickens it is possible to also provide cooked chickens at a lower cost than if both tasks were performed separately. Supermarket transport and distribution plants also create economies of scope, where it is cheaper to transport and distribute many products jointly than on a single product basis.

Finally, regardless of income levels, Australian consumers have continued to demand highly competitive pricing. This is evident from the strong price competition between the major retailers and the various other promotions used to attract consumers. These include ‘loss leaders’ that aim to attract consumers into the store by retailers actually facing a loss on certain items in order to capture the remainder of the consumers’ spending. The use of discount vouchers has become prominent in Australia, especially for petrol and alcohol. When consumers have purchased groceries over a set dollar value they have been provided with a voucher for a discount on petrol from participating outlets and also alcohol discounts for the in-store liquor outlets. During volatile and escalating petrol prices, the petrol vouchers have become a continuing issue for consumers.

The main providers of the vouchers have been Woolworths and Coles, which have established relationships with petroleum retailers to create a network of supermarket-aligned petrol station networks. The actions of the smaller grocery chain ‘IGA – Independent Grocers of Australia’ indicate the importance of the petrol voucher issue. Instead of creating a network of aligned petrol station, IGA have allowed consumers to purchase petrol from any petrol retailer and receive the discount off their grocery bill after a minimum in-store spend requirement has been fulfilled. Gans and King (2004) have analysed the relationship between price discrimination and the discounts for groceries and petrol schemes. They have argued that these schemes could have potentially undesirable outcomes.

Foreign investment in Australia’s retail food sector

The emergence of the ALDI supermarket chain, a German owned company, has been one important source of foreign investment into the Australian retail food sector in the past five years. The first ALDI store opened in Australia in January 2001 and has expanded throughout New South Wales, Queensland and Victoria. ACNielsen (2004) reported that nearly all the growth in the independent retail market share since late 2000 could be attributed to ALDI.

ALDI currently has 44 stores in New South Wales, accounting for 5 per cent of total packaged grocery sales and up to a 10–12 per cent volume share in some other categories. In Victoria, ALDI owns 20 stores and accounts for 2.5 per cent of packaged grocery sales (ACNielsen 2004, p. 16). It is reported that ALDI’s target for 2010 is for over 300 stores and 10 per cent of the Australian packaged grocery market. Such expansion may need to be funded by large foreign investment.

The ALDI product range does not consist entirely of imported products. With many of ALDI’s products being produced in Australia, ALDI has created some domestic employment and economic activity at both the retail and food manufacturing sector levels. ALDI’s presence and expansion is likely to place some competitive pressure on the major supermarket chains and the existing independent retailers.

Impacts on traditional and small retail outlets

The traditional outlets are becoming smaller in number and are declining in importance. Previously, many small outlets like the local corner stores were open longer hours to cater for small purchases at times when larger stores were closed. Now supermarkets are open long hours and provide a wide range of goods and services at highly competitive prices. Traditional and small retail outlets are finding it difficult to compete against the large supermarkets following the loss of their 'convenience' related comparative advantage after trading hours were deregulated. The limited extent of economies of scale prevents smaller and traditional outlets from competing based on price. These outlets have needed to differentiate themselves from the large supermarkets through servicing a niche market, specialisation and a higher level of personal service.

There are a number of niche markets that larger retailers may be unable to adequately service. Niche marketing often requires specialisation that enables a retailer to provide a range of a specific type of product and have a detailed knowledge of their products. The extra knowledge and the smaller nature of the retail outlets allows for a greater level of personal service. The prices at the smaller retail outlets are often higher than the prices of products at larger retail outlets, but some consumers are likely to pay the higher prices if they are being provided with additional services. Larger retail outlets are often unable to provide the same level of service, knowledge or range of a specific product because of the additional high cost.

Impacts on domestic agriculture and trade

There have been some positive outcomes from the concentration of the retail food sector in Australia. Farmers who have managed to meet supermarket requirements in terms of product quality and food safety have been able to sign contracts that provide agreed prices and a guaranteed buyer of their produce. For some farmers, such price stability can provide greater certainty and a more stable cash flow for farm planning purposes. Another benefit has been the increased flow of information to producers of consumer requirements. Producers need to know what the end user is demanding to best meet their requirements and possibly attract a price premium. Improved information flows have the ability to increase the effectiveness of market signals throughout the industry.

As retail grocery chains have become larger, they have increased their level of innovation and product development effort. Supermarket chains have stimulated many changes that have altered the way that produce has been handled and the costs of doing business. The implementation of bar coding and various inventory holding mechanisms has increased the efficiency of supply chains and reduced costs and increased efficiency for agricultural producers. Retail grocery chains have also applied pressure for product changes that have resulted in superior product varieties that have benefited all parties concerned.

On the other hand, there is some anecdotal evidence to show that the market power of Woolworths and Coles is often leaving certain agricultural producers in a ‘take it or leave it’ situation (see Wade and Bradley 2002). It has been argued that producers either accept the terms of the retail grocery chains or risk not supplying Australia’s two largest retail food outlets. Wade and Bradley (2002) reported that the standards that supermarket chains impose on growers to maintain their standards accreditations tend to reduce producer profitability in certain cases. This has resulted in some producers diverting their produce to export markets (Wade and Bradley 2002). This shows the impact that retail grocery chains can have on both trade and domestic agricultural production. Adamson and Hunt (2005) argued that the move toward increased generic house brands may result in greater imports for generic branded products and have an adverse impact on production of national brands.

Some concluding remarks

The Australian retail food sector is highly concentrated and dominated by two large supermarket chains. The sector has been changing over recent decades, which has increased the efficiency of the sector with benefits in certain areas being passed on to consumers.

Given the high level of market concentration within the Australian retail food sector, it is important that competition policies are equipped to deal with issues that may arise from such market conditions. This is required to ensure that business practices in the national interest are maintained. In Australia, this is the role of the Australian Competition and Consumer Commission (ACCC), an independent statutory authority.

The large supermarket chains are likely to continue to compete with other retailers by constantly seeking to lower product and transaction costs and the associated risks. This means that agricultural producers will have to continue being price competitive in this sector. Agricultural producers who can continue to be price competitive in the retail food sector and meet the product quality and food safety requirements of the supermarket chains will have a better chance of capturing the potential benefits of the ongoing retail food sector transformation in Australia.

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Introduction

- 2003-04 Australian retailing industry-\$200b
- Supermarkets and grocery stores -\$55b
- Continuing changes over the past decades
- Important implications for consumers and producers
- Some efficiency improvements in the retail food sector
- Industry concentration can have a bearing on further capturing efficiencies

Australian Retail Food Trade - 2003-04

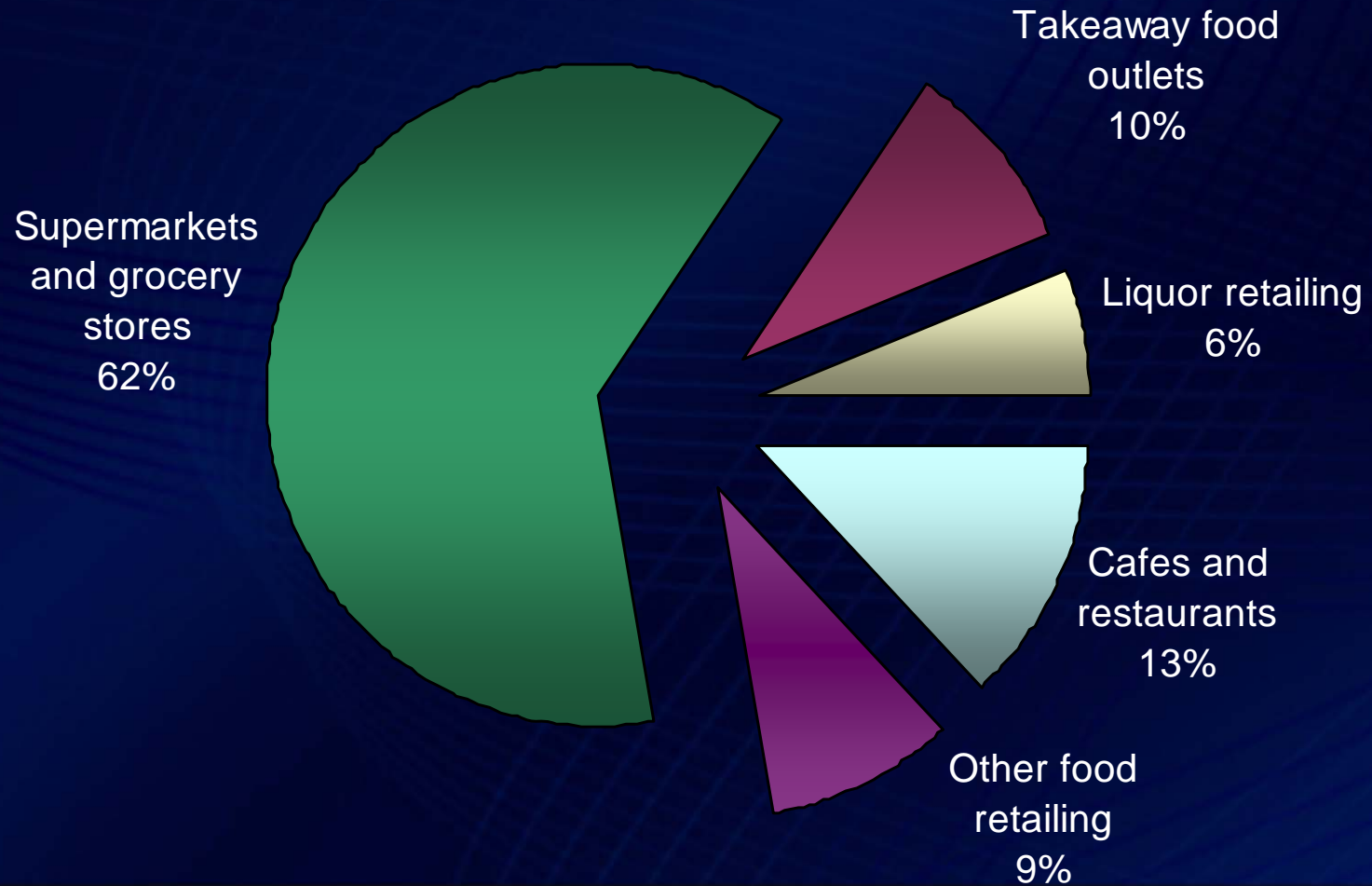


Table 1 - Australian Retail Food Trade

	2000-01 A\$m	2001-02 A\$m	2002-03 A\$m	2003-04 A\$m	Share of total food and liquor retailing 2003-04 %
Supermarkets and grocery stores	45,191	48,617	51,686	55,136	62
Takeaway food outlets	6,844	7,229	7,744	8,556	10
Liquor retailing	3,619	3,880	4,520	5,322	6
Cafes and restaurants	9,061	9,160	9,737	11,634	13
Other food retailing	6,801	7,881	8,205	8,087	9
Total food and liquor retailing	71,515	76,767	81,891	88,735	

Source: Department of Agriculture, Fisheries and Forestry (2005, Table 4.1, p. 57)

Market Structure

- Australia has one of the most concentrated retail food sectors in the developed world
- Two supermarket chains – Woolworths and Coles dominate the market
- Many of the major developed countries have a relatively lower market concentration compared to Australia

Table 2 - Global Retail Grocery Market Shares - 2001

	Market Share %	Number of Firms
Australia a	76	Top 2
Canada	56	Top 5
Singapore	55	Top 5
Germany	53	Top 3
United Kingdom	52	Top 3
France	44	Top 3
Taiwan	40	Top 5
United States	34	Top 5
Thailand	22	Top 5
Philippines	20	Top 5
Malaysia	14	Top 5
Japan	7	Top 5
Korea	5	Top 5

a NARGA Estimate for 2002

Source: National Association of Retail Grocers of Australia (NARGA)

Growth of generic products

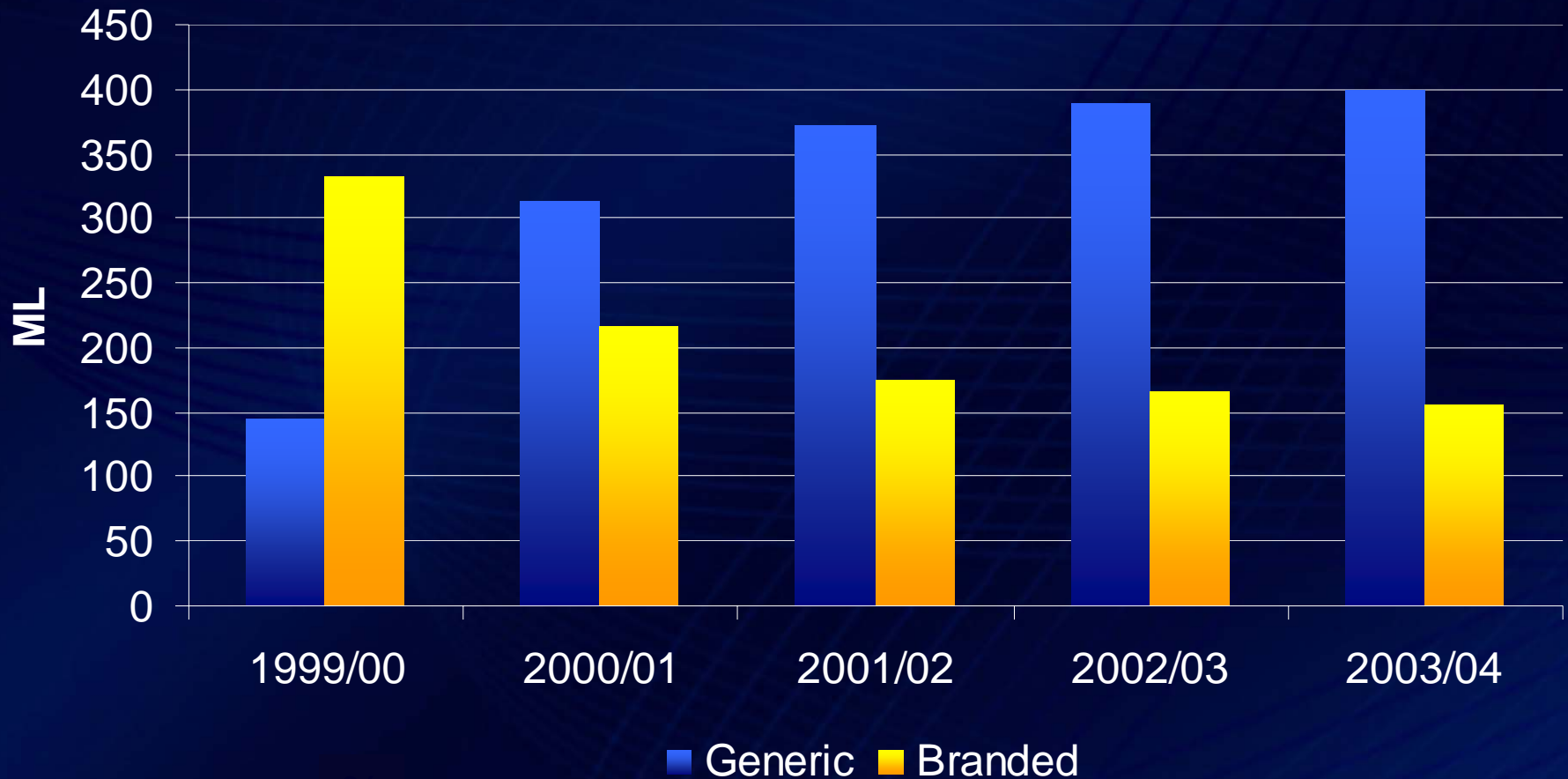
- Major trend in the past few years – emergence of generic products
- Fresh milk is a good example
- Supermarket pressure on the major fresh milk processors
- Lower generic fresh milk prices
- Consumer shift from branded milk to generic milk

Table 3 - Australian supermarket milk sales - regular whole milk

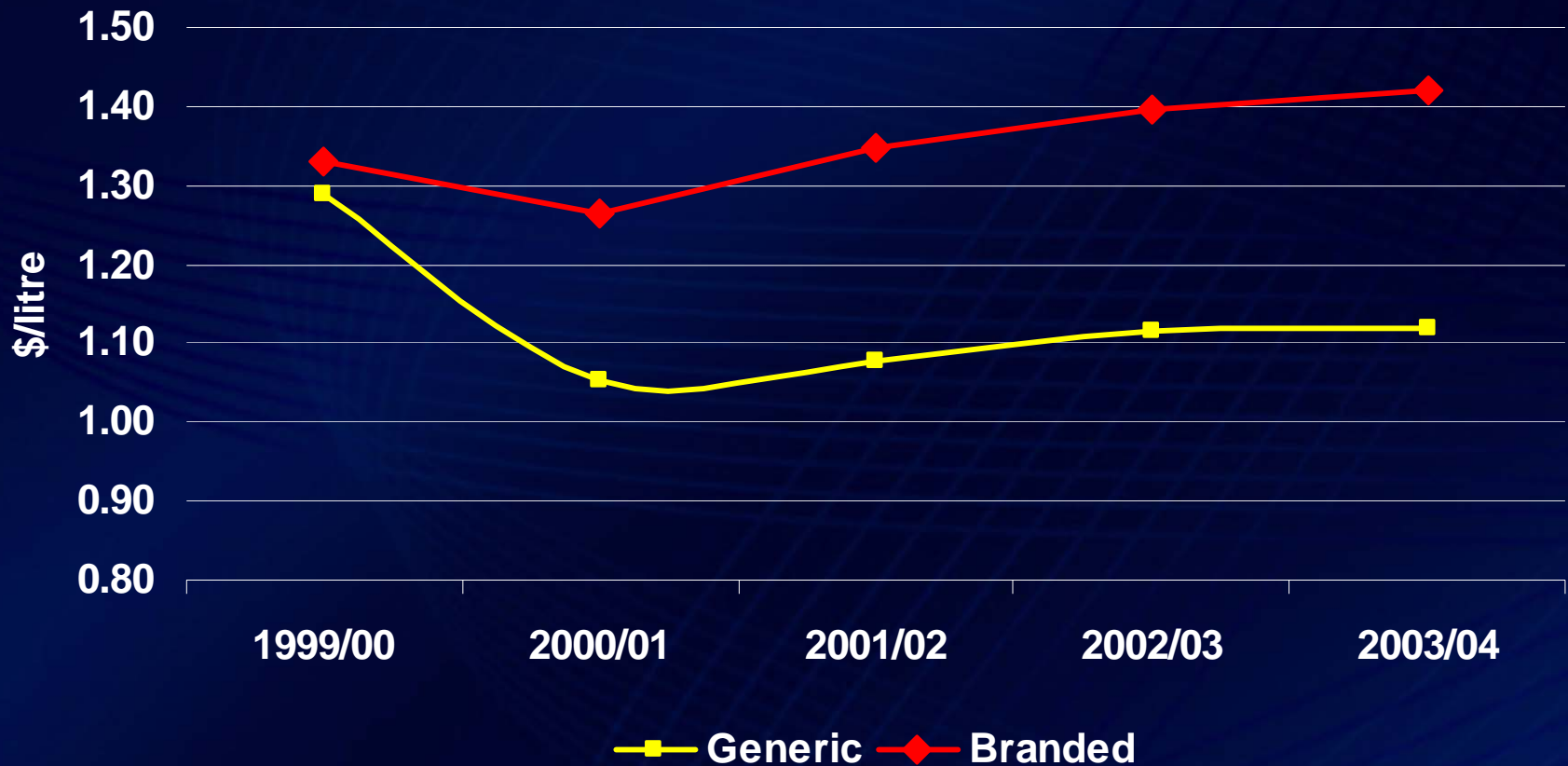
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Source: Hogan, Shaw and Berry (2004, p. 35)

Australian supermarket milk sales – regular whole milk



Australian supermarket milk sales – regular whole milk



Consumer issues

- Convenience - one-stop shopping and extended trading hours
- Expanded product range and mix
- Food quality and safety
- Bundling of services (groceries and petrol vouchers)
- Benefits of economies of scale and scope
- Some winners and some losers

Other issues

- Emergence of ALDI, a German owned firm
- Decline of traditional and small retailers
- Stringent requirements on product quality, food safety – producers need to meet
- High level of market concentration means need for adequate competition policy oversight – role of the ACCC