15 December 2014

Agricultural Competitiveness Taskforce
Department of the Prime Minister and Cabinet
PO Box 6500
Canberra ACT 2600

Attention: Mr Paul Morris

Dear Sir,

Coles is pleased to lodge the attached submission on the Agricultural Competitiveness Green Paper to the Taskforce.

Coles' success is very much dependent on the success of the Australian agricultural sector. We welcome the opportunity to contribute to the debate and believe that the best way of guaranteeing strong returns to farmers in the future will be by increasing competitiveness across the sector.

This debate needs to be evidence-based. In its submission, Coles has drawn on its experience and relationships with hundreds of farming businesses across Australia to discuss farm gate returns as well as the opportunities that are arising from farmers leveraging their relationships with Coles to secure capital to expand and improve their businesses.

Our submission builds on the central themes outlined in the Green Paper and focuses on four key areas:

- the importance of cost of living issues and the need to ensure Australians have access to high quality agricultural produce at affordable prices;
- the importance of boosting productivity and improving competitiveness across the supply chain from the farm gate to the end consumer;
- the importance of supplier relationships; and
- the importance of competition and getting regulatory settings right.

Coles looks forward to working with the Government as it frames a policy agenda that will allow Australia's agricultural sector to achieve its growth potential. We would be pleased to meet with you to discuss our submission.

Yours sincerely

Peter Crone
Chief Economist

coles
A little better every day

Coles' Submission on the Agricultural Competitiveness Green Paper

December 2014

Overview

The competitiveness of agriculture is important for Australia, its farmers and for consumers. A strongly performing farm sector sustains regional communities and contributes to Australia's economic growth ambitions.

As a retailer, Coles is customer-led. One of the biggest challenges confronting Coles' customers is the cost of living, particularly at a time of slowing growth in incomes. Reflecting this, the challenge for Coles is to provide consumers with high quality products, including fresh produce, at affordable prices.

A key to this is having strong relationships with its suppliers. Fundamentally, Coles cannot be successful unless its supplier base is successful. This is a major reason behind Coles' increasing use of long-term supply contracts with agricultural producers. These agreements provide greater certainty and are helping to underpin significant investment in the sector.

Lowering costs in order to keep prices down will require continuing productivity improvements, not only at the farm level but also throughout the retail supply chain. A greater understanding of how this chain works and increased transparency around its operation are important considerations.

If Australia is to have a truly efficient, competitive agricultural sector the right regulatory settings must be in place. The Green Paper acknowledges this. Effective self-regulation and the removal of market constraints and impediments to doing business are central to this.

Coles is pleased to make a contribution to the Government's Agricultural Competitiveness policy process. This submission builds on the themes in the Green Paper and focuses on four key areas:

- Section One highlights the importance of cost of living issues and the need to ensure Australians have reliable access to high quality agricultural produce at competitive prices;

- Section Two focuses on productivity of the agricultural sector and the competitiveness and transparency of the supply chain from the farm gate through to the end consumer;

- Section Three discusses the importance of supplier relationships, drawing on Coles' strong and enduring relationships with hundreds of farming businesses across Australia and the positive spill-over effects of this on the sector;

- Section Four discusses the importance of competition and ensuring the right regulatory settings are in place.

Coles welcomes the opportunity to contribute to the debate and recognises that the best way of guaranteeing strong returns to farmers in the future will be by increasing competitiveness across the sector.

The elements of the productivity challenge identified in the Green Paper - realising better access to markets, adoption of the latest technology, connected infrastructure, access to finance, less regulation and open and transparent competition – are the right areas of focus.

Section One: Cost of Living

After housing, spending on food represents the largest share of the household budget. The weighting allocated to food by the Australian Bureau of Statistics in the basket of goods and services used to calculate the Australian Consumer Price Index is 16.8 per cent.[i]

Around half of this comprises bread and cereals, meat and seafoods, dairy and fruit and vegetables.

This weighting derives from the ABS Household Expenditure Survey for 2009-10 and reflects an average household spend on food in that year of $231 per week out of total average weekly household spending of $1,370.[ii]

For those households reliant on government pensions and payments as their main source of income, the average proportion of spending on food is estimated by the ABS to be higher at around 20 per cent.[iii]

Movements in food prices therefore have a significant impact on households.

The economic climate in Australia at present is characterised by an uncertain growth outlook, slowing income growth, a subdued labour market and soft consumer confidence.

The latest National Accounts suggested that wages are growing at around 2 per cent per annum in nominal terms which is less than half of their historical average of 4 to 4½ per cent per year. After adjusting for inflation, growth in real wages has been flat or negative for the past two years.[iv]

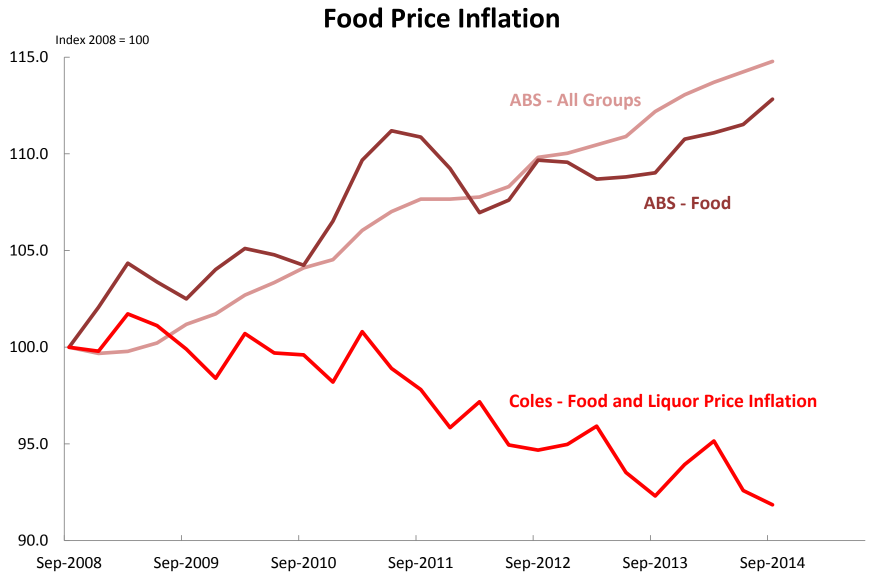
Source: ABS Cat No: 5206.0

In this environment cost of living pressures are likely to be exacerbated, and retailers will be under renewed pressure to keep their prices down.

Over the past six years, the ABS Consumer Price Index measure of economy-wide inflation has risen at an average rate of 2.6 per cent. The Food component of the index has risen at a slightly lower pace, averaging 2.2 per cent per year.[v]

Since 2008 Coles has placed the highest priority on delivering value to customers by keeping prices down. By improving efficiencies in its operations and throughout the supply chain, Coles has been able to return savings back to customers through lower prices.

In the period since the September Quarter 2008, food and liquor deflation at Coles has averaged 0.8 per cent per year.[vi]



Source: ABS Cat No. 6401.0, Coles

A strongly competitive agricultural sector and efficient and innovative supply chain will have a major bearing on future movements in food prices, as will the extent of competition in the supermarket sector.

For Coles, a priority will be to ensure consumers can continue to get access to quality fresh produce at affordable prices.

Section Two: Agricultural productivity and supply chain transparency

The success of Australia's agricultural sector depends largely on growth in the demand for food, globally and domestically, and the capacity of the sector to supply the necessary agricultural produce that consumers want.

Food demand, in turn, is largely driven by growth in population and growth in per capita incomes. These drivers have been strong in Australia for the past decade although, as noted above, there has been a weakening in incomes in recent times. The rise in per capita income that is taking hold in the broader Asia-Pacific region is a major structural development and is expected to substantially increase opportunities for Australian farmers.

Food demand is also being influenced by changing consumer preferences which include a rising tendency for healthier eating, a preference for locally produced products, a desire for convenience to reduce meal preparation times, and concerns over the environment and animal welfare.

Sales of food and food-related items make up around three quarters of Coles' annual revenue. Fresh food categories drive more than 30 per cent of sales, and sales of fruit and vegetables are currently amongst the fastest growing category.

96 per cent of fruit and vegetables sold by Coles are Australian grown, 100 per cent of our fresh meat is sourced from Australian farms as is 100 per cent of Coles Brand fresh milk.

Coles has a significant presence around regional Australia. Around 30 per cent of the team members Coles employs are located in stores in regional areas. Coles also operates major distribution centres in Goulburn and Townsville.

In terms of sourcing Australian agricultural produce, Coles is a substantial player though it is not dominant.

- The estimated 750,000 tonnes of fresh fruit and vegetables sold by Coles last financial year accounted for around 14 per cent of total Australian fruit and vegetable production[vii];
- The beef volumes that Coles accessed last year from 500,000 head of cattle represented a little under 6 per cent of the nine million cattle slaughtered in Australia[viii];
- Last financial year Coles sold around 60 million chickens (and chicken equivalents) representing around 10 per cent of the six hundred million birds processed in Australia[ix];
- Our sales of fresh milk – both Coles Brand and branded milk – of 400 million litres per year account for a little over 15 per cent of the 2.5 billion litres of drinking milk produced in Australia[x].

Growth in the supply of Australian agricultural commodities in recent years has been primarily driven by growth in farm sector productivity, as growth in the availability of land and water resources for agricultural production have become more constrained.

Agricultural productivity growth will be a pivotal determinant of long-term growth in the supply, availability and price of food over the coming decades.

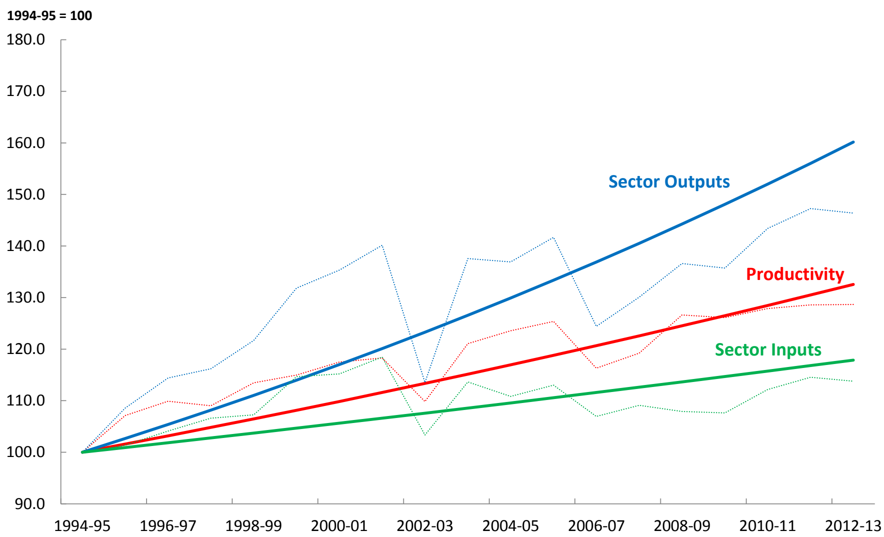
At the farm level, improvements in productivity reflect an increase in output produced from land, labour, capital and other inputs. Measured at the industry level, productivity growth also reflects changes in industry structure, including the exit of less efficient farm businesses and more efficient resource use across farms. Productivity growth has also been influenced by drought and other factors that are beyond the control of farmers and government.

Historically, prices paid for inputs by farmers have typically grown faster than the prices received for their output, so growth in productivity has been essential for maintaining farm gate returns.

The ABS has produced estimates of industry sector productivity including for the agriculture sector. Recognising that there are inherent uncertainties in these estimates, they nevertheless suggest that multi-factor productivity in the Agriculture, Fisheries and Forestry sector has been reasonable – increasing by an average of 1.6 per cent per year between 1994-95 and 2012-13[xi].

Over this period, the ABS estimated that the sector's output grew at an annual average rate of 2.7 per cent, while combined inputs grew at an average annual rate of just under 1 per cent.

Agriculture, Fisheries & Forestry: Inputs, Outputs and Productivity



Source: ABS Cat No. 5260.0.55.002

In terms of international comparisons of agricultural productivity there is limited information available, though on the evidence at hand Australia has performed reasonably well. A March 2013 report from the Rural Industries Research and Development Corporation (RIRDC) compared trends in agricultural productivity and competitiveness in Australia, Canada and the United States over a 45 year period.

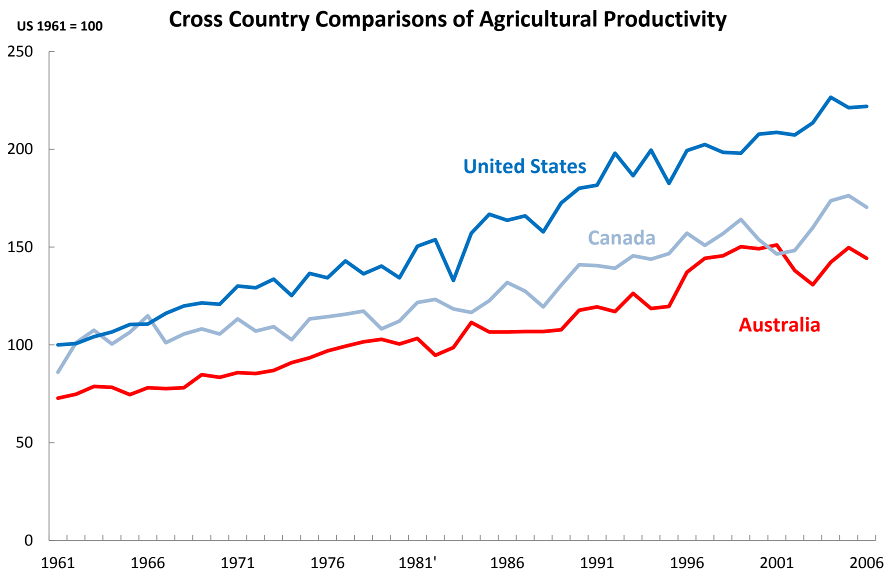
Over the period 1961 to 2006, total factor productivity growth was most rapid in the United States' agricultural sector (1.8 per cent per year on average) followed by Australia (1.6 per cent per year) and Canada (1.2 per cent per year)[xii].

The RIRDC report noted that productivity growth rates have varied considerably between the three countries. Australia achieved more rapid agricultural productivity growth than both the United States and Canada in the 1970s and 1990s while US growth surged in the 1960s and 1980s. The report further notes that:

> 'The results suggest Australian agriculture has been less competitive than the United States and Canada in terms of absolute advantage. Lower productivity implies that, in aggregate,

Australia has faced higher per unit production costs which have disadvantaged it on world markets.

In spite of this, Australian agriculture has maintained its relative productivity and, in turn, its competitiveness at around 70 per cent of the United States, which is seen as a global leader in agriculture.'[xiii]



Source: RIRDC 2013

As noted in the Green Paper, Australia's agriculture sector has shifted towards more intensive farming with a greater number of large scale farms. It is also characterised by greater integration within the global agrifood chain.

Innovation has been and will continue to be the main driver of farm level productivity as farmers reduce costs by adopting more efficient technologies and management techniques. Securing the capital needed for this investment will be a central challenge in the period ahead.

The Green Paper also highlights another key challenge for the sector – the significant variation in the performance of farms with the higher performing farms producing more than half of the agricultural sector's output.

To increase the overall competitiveness of the Australian agricultural sector an objective must be to improve the performance of all farms towards the levels achieved by the best performers.

In seeking to achieve this, it is helpful to recognise that the success of one business can and should drive others to respond and seek to emulate its achievements. If less efficient producers close the gap even while sector leaders are further increasing their productivity performance, then this will help boost the aggregate productivity performance of the economy.

The alternative of maintaining the status quo is not viable and the challenge of closing the performance gap must be taken up by all participants in the industry.

Farm Gate Pricing

The Government has set the achievement of better returns at the farm gate as a key objective in ensuring a sustainable and competitive agricultural sector. As highlighted above, the best way of guaranteeing strong returns to farmers in the future will be by increasing competitiveness across the sector.

Issues around farm gate pricing involve considerable complexity. There is a range of factors that influence the relationship between the prices farmers receive for their products, the prices sellers pay to secure these products and the retail prices that consumers ultimately pay.

These factors include international influences (whereby many Australian farmers are price takers in world markets), the degree of value-add and product transformation, the structure of markets in different categories and the intensity of competition.

As noted above, the Australian agricultural sector has a number of unique characteristics that set it apart from other industries, especially its exposure to variable growing conditions. However, like all sectors it must face the realities of a market-based economy and the inescapable forces of supply and demand including those dictated by global markets.

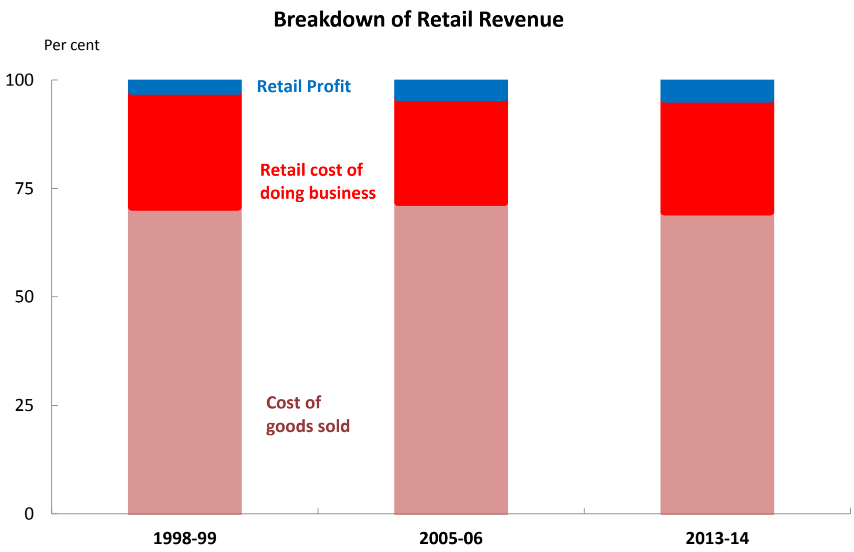
Retailers play a vital role in getting produce to end consumers. They add value by providing an important service to customers; by arranging, storing and displaying a selection of goods in convenient locations across Australia and making them easily available for customers to buy. In doing this retailers must anticipate and interpret the needs of their customers whose preferences and buying habits are many and varied and in a constant state of change.

To understand the factors that influence trends in the prices of retail goods it is necessary to appreciate the costs incurred and margins applied by distributors – retailers and wholesalers – in the process of getting goods to consumers.

Past Australian studies[xiv] [xv] have found that, on average, around half of the final price of retail items can be attributed to the cost of good themselves, with the remaining half covering the gross margins of wholesale and retail firms in the distribution supply chain.

For the wholesaler, the costs of doing business include expenses paid to its staff, landlords and freight providers as well as the holding costs of inventory.

For retailers, their purchases (that cover the cost of goods sold and any wholesale margin) have tended to account for about 70 per cent of the final selling price. The remainder of the selling price is split between the retail cost of doing business (around 25 per cent) and the retailer's net profit (around 5 per cent). These proportions have remained roughly around these levels over the past fifteen years.[xvi]



Source: ABS Cat No: 8622.0, Productivity Commission

The main costs of doing business for retailers are the wages paid to staff, rent and energy costs as well as marketing, packaging and administration expenses. The competitiveness of the market in which the good is sold also has a bearing on the gross margin which applies.

In the case of full service supermarkets, an important additional consideration is the fractionalisation of costs. By fractionalising costs through millions of transactions each week, supermarkets are able to lower their costs overall and therefore their prices to consumers. In seeking to maximise value from high volume, low margin sales there is a constant discipline to stay competitive.

This broad framework is useful when considering costs and margins that prevail in the supply chain for the agriculture sector and in understanding why the prices paid by consumers may vary from the prices received by farmers.

Fresh Fruit and Vegetables

Wholesale fresh produce markets which operate in the capital cities and elsewhere play a major role in setting and reporting prices for fruit and vegetables. These markets handle around half of volumes produced.

Prevailing growing conditions and seasonality of supply have the greatest influence on wholesale and retail prices.

Coles, like other supermarkets and major grocery buyers, prefers direct supply arrangements with fresh produce growers. These arrangements offer certain advantages including by improving efficiencies that allow produce to get to our stores more quickly and in helping to ensure that quality and appearance specifications are met. They also help Coles and producers achieve greater certainty over supply.

As discussed in further detail below, these direct supply arrangements work to the advantage of farmers who typically obtain a higher price than the average achieved in the wholesale markets.

That said, the fresh fruit and vegetable market is fragmented and diverse – across product types, farm size and the degree of integration through the supply chain. There are also significant supply fluctuations and price fluctuations in many fresh produce categories as part of regular seasonal cycles.

In 2012 Coles commissioned independent analysis from the agribusiness consultant *FreshLogic* to examine a breakdown of the retail price within the overall supply chain including to producers, processors and retailers. This analysis has been updated for 2013 and 2014 by *FreshAgenda*.

Over the past two years, for most fresh produce categories the primary producer received between 40 per cent and 67 per cent of the selling price, with the average being around 54 per cent. [xvii]

The supply chain costs associated with getting the fresh produce from the farm to market include storage, handling, ripening, packing and packaging materials and transporting. These costs vary by category of fruit and vegetable reflecting their particular characteristics – for example the need to trim and package broccoli and ripen bananas and mangoes – which can represent up to 10 to 20 per cent of the retail price.

Once the goods have been bought, the retailer's cost of doing business – including staff, rent, energy costs and overhead - need to be covered as well as a net margin.

The table below, drawing on the material from *FreshAgenda,* provides an illustrative example of the costs and retailer margins involved in the sale of a kilogram of apples in 2014[xviii].

Table 1: Farm gate prices, costs and margins: Apples

	Price/cost per kg	**Per cent of Retail Price**
Farm Gate	**$2.53**	**57.7%**
Packing, transport & other wholesale costs	$0.39	8.8%
Buy price	**$2.92**	**66.5%**
Retailer cost of doing business	$1.21	27.6%
Retail net margin	$0.26	5.9%
Retail sale price	**$4.39**	**100.0%**

Source: FreshAgenda

Fluctuating seasonal conditions can result at times in over and under supply of produce with flow on effects on price, both at the farm gate and retail level. In the above example, if a period of over supply persisted and the farm gate price fell by 20 per cent (or around 50 cents per kilogram) the retail price would be expected to decline by a similar magnitude (i.e., 50 cents per kilogram). The farm gate share of the retail price would, however, fall.

Alternatively, if a period of supply shortage occurred and the farm price rose by 20 per cent (or 50 cents per kilogram) the retail price would likewise rise. In this case, the farm gate price as a proportion of the retail price would rise.

Beef

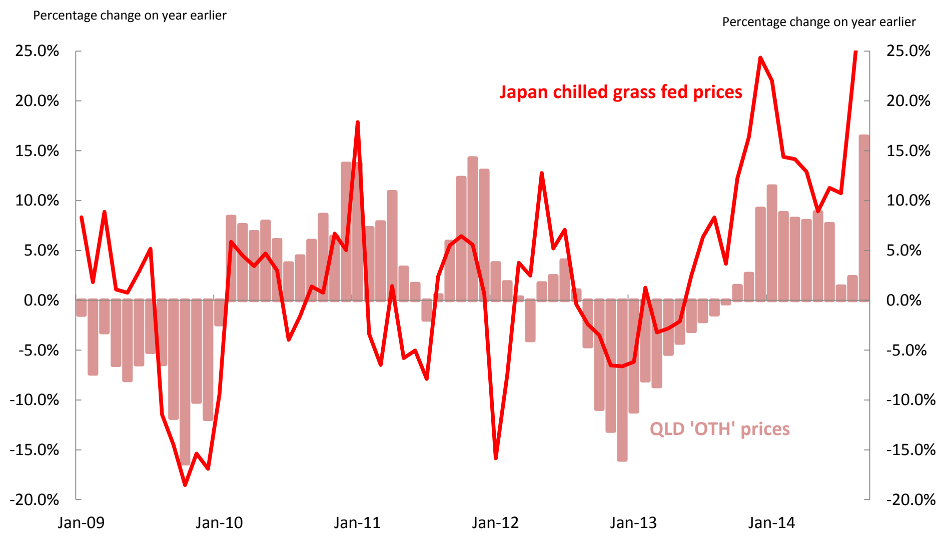
By contrast, the relationship between farm gate prices and retail prices in the beef and meat category necessarily involves a number of different considerations to those of fresh produce.

In particular, there is a significant international influence that applies to many parts of this sector.

As noted in the Green Paper, the Australian beef sector is dominated by major production and processing facilities which have developed to service export markets. With around two thirds of the Australian beef produced sold for export, meat prices domestically are essentially set by international prices.

The chart below shows movements in the price of Japan chilled grass feed beef against movements in the Queensland 'over the hooks' price. While the correlation is not perfect it nevertheless highlights how the Japanese price is a major driver of the farmgate price in Queensland.

Beef Prices - Japanese chilled grass fed v QLD 'over the hooks'



Source: FreshAgenda, Meat and Livestock Australia

In understanding farmgate returns, as well as international factors there are also issues associated with meat 'yield' that need to be taken into consideration.

The return received at the farm gate should take account of the dressed carcass and the loss of unsaleable weight and processing waste. For example, a 500 kilogram 'liveweight' animal will typically weigh 250 kilograms as a 'dressed' carcass.

With around three quarters of the dressed carcass comprising 'saleable meat' the weight of saleable meat sold at the farm gate would typically be around 185 kilograms.

So as shown in the illustrative example in Table 2 below, if a 500 kilogram animal/250 kilogram dressed carcass is sold for $1,000, the implied farm gate price for the 185 kilograms of saleable meat would be around $5.40 per kilogram.

This is before adding abattoir, refrigeration and distribution costs. Some other income is also received from carcass waste products including hides, bones and render although this income is less than processing costs.

In making comparisons with retail prices it is important that the ‘liveweight’ to ‘saleable meat’ conversion is made and the transformational costs of preparing meat for sale are taken into account.

Table 2: Illustrative Farm Gate Pricing – The Importance of Yield

	Kilograms	Revenue to farmer	Price/Implied price per kg
Liveweight	500	$1,000.00	$2.00
Dressed carcass	250	$1,000.00	$4.00
Saleable meat	185	$1,000.00	$5.41

Source: Coles

From a retailer’s perspective, the price of beef sold varies by cuts with flank, sirloin and forerib typically around or above $20 per kilogram. At the other end of the range, mince retails at around $5 to $6 per kilogram.

The average beef retail price published by ABARE suggests a price of around $15.50 to $16.30 per kilogram[xix]. This estimate is based on ABS price estimates of roast beef, rump steak, t-bone steak and chuck steak. Once account is taken of the significant volumes of mince sold, the weighted average retail price of beef is estimated to be around $10 to $11 per kilogram.

On this basis, and using the illustrative example above, a farm gate price of saleable meat at around $5.40 per kilogram would represent half of the average retail price across all beef categories.

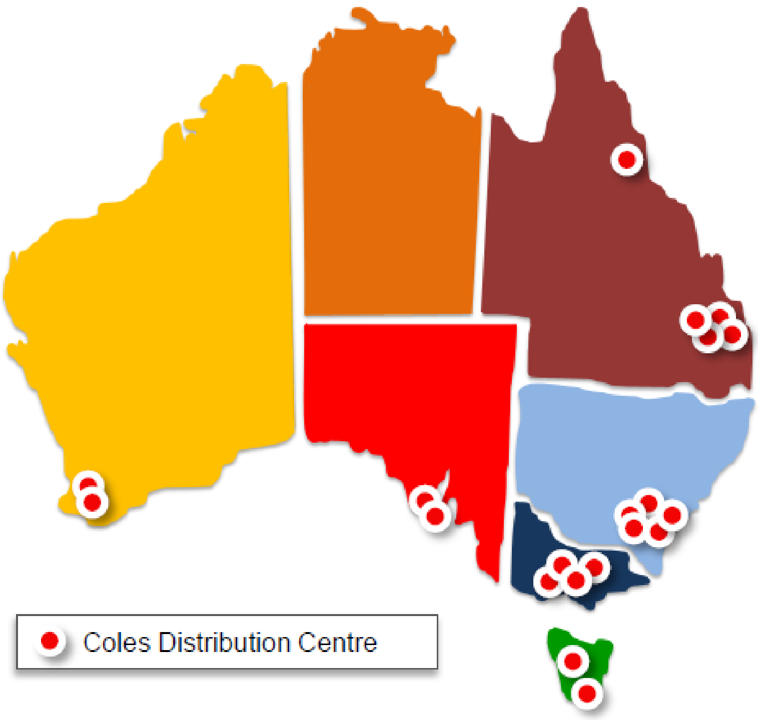
Improving the efficiency of the supply chain

Improving the efficiency of its end-to-end supply chain is fundamental to Coles’ efforts to get agricultural produce from growers to the customer. Speeding up the pace that a product moves through the supply chain enables a shorter ‘field to shelf’ lead time and therefore greater shelf life in store.

All parts of the end-to-end supply chain matter from automated ordering systems, improved efficiencies within distribution centres as well as the transport task.

Since 2008, Coles has moved from having 32 distribution centres to 20 today. These distribution centres are now handling more than 800 million cartons each year and move over 75 per cent more volume than they did in 2008[xx].

Figure 1: Coles Distribution Centres



Coles orders a significant proportion of its grocery range into store via its automated sales-based system known as *Easy Ordering.* In the case of fresh produce, it is currently rolling out a system of assisted ordering[xxi]. These systems incorporate sophisticated technology and allow Coles to share demand data with its suppliers thereby enabling them to improve their own production planning and improve the use of their resources. As the systems are introduced and bedded down this is expected to contribute to lower costs and improved service levels. It should also assist Coles in better managing on-shelf availability.

Coles is also seeking to improve the efficiency within the transportation function. It is rolling out a fleet of Coles' owned trailers fitted with specifications that meet its needs including greater capacity to accommodate fit-for-purpose roll-cages and pallets.

Coles is also investing in a transport planning system involving end-to-end deliveries and dispatch through the distribution centres and into stores at exactly the right time for that store, for the road network and for the distribution centre. It is also trialling GPS cab technology that will allow greater tracking, and transparency of delivery performance including minimising lost waiting times.

The combined benefits of increased capacity utilisation, greater volumes and increased on-time deliveries result in lower costs which are passed through to consumers through lower prices.

Section Three: Supplier relationships

A priority of Coles is to ensure that it can meet the expectations of its customers by sourcing and securing quality fresh produce and getting it to consumers as quickly and efficiently as possible.

Achieving this requires strong relationships with suppliers.

Over the past five years Coles has adopted a new approach to sourcing food with an emphasis on delivering quality, service and value to customers while at the same time fostering growth and innovation for our producers.

Coles has moved from a transactional approach whereby suppliers could change from one day to the next to a new approach with a greater emphasis on partnerships and direct relationships with growers.

This builds on the many relationships that Coles has with suppliers that are deep and long-standing. Many of its suppliers are family owned and run businesses.

By committing to volumes and making greater use of medium and long-term contracts with its suppliers, a relationship with Coles can help provide growth, security and greater certainty for business planning.

As an indication of its commitment to this approach, Coles has also demonstrated a preparedness to undertake co-investments with suppliers.

One of the key areas of interest for the Agricultural Competitiveness Green Paper is an objective of finding effective finance mechanisms to provide farmers with the capital they need to grow.

The long-term nature of contract arrangements provide stability for suppliers, with banks often recognising the value of these agreements when it comes to accessing finance for expansion.

Some recent examples of major investments undertaken by Coles suppliers are outlined below.

- Coles' ten-year partnership agreement with Devondale-Murray Goulburn to supply Coles brand pasteurised milk underpinned a $150 million investment[xxii] in two purpose-built milk processing facilities in Melbourne and Sydney. This was one of the most significant investments in Australian dairy processing since the industry's deregulation in 2000. The new facilities which commenced operations in mid-2014 have helped drive down production costs and improve efficiency.

- Coles has had a forty year relationship with its beef supplier Australian Country Choice (ACC) in Queensland. The existence of long term agreements with Coles has allowed ACC to invest in a dedicated and sustainable supply chain to ensure a continuous supply of beef products 52 weeks of the year. Underpinned by its ongoing relationship with Coles, since 2001 ACC has invested $150 million[xxiii] into its operations including a purpose built processing facility at Cannon Hill.

- The Mitolo Group, a major South Australian supplier of potatoes and onions to Coles is focused on innovation, research and development. During its five year relationship with Coles, it has developed new potato varieties and with greater scale, Coles understands that Mitolo has undertaken a $5 million investment in new packing equipment.

- Berry Sweet a family owned strawberry grower based in Bullsbrook in Western Australia leveraged its relationship with Coles to expand into a new operation at Pemberton in the state's south so that it can produce fruit in summer and supply for 12 months of the year. Coles understands that that Berry Sweet invested $5 million as part of this expansion plan.

- Rocky Ponds Produce, located at Gumlu in Northern Queensland, sells 40 per cent of its capsicums, rockmelons, honeydew melons and pumpkins to Coles. The direct relationship this business has had with Coles for more than a decade provided the foundation for additional investment to expand and upgrade Rocky Ponds' plant and equipment. Coles understands that this investment was in the order of $2 to $3 million, with associated construction undertaken by local businesses.

- On the back of a new four year supply contract, the Western Australian integrated agribusiness Milne AgriGroup has indicated it will treble its production of free range pork. The expansion will have flow on effects to processing businesses and is expected to lead to increased investment in processing plant and equipment in the region.

- A ten year contract to supply truss tomatoes that Coles negotiated with Sundrop Farms was influential in the company's ability to attract $100 million of private equity financing[xxiv] to construct a state of the art 20 hectare greenhouse facility at Port Augusta in South Australia.

Supplier Charter

As the above examples demonstrate, Coles works with businesses of all sizes. With consumers demanding competitive prices Coles finds itself under constant pressure to meet the expectations of its customers. In such an environment it is inevitable that commercial dealings will be hard fought and disputes will arise from time to time.

Coles fully supports the development of appropriate means to resolve these disputes including through alternative dispute resolution mechanisms and other processes through which small businesses can access remedies.

To this end, Coles has developed its own Coles Supplier Charter which includes a process for resolving commercial disputes. The Charter is a transparent and formal framework under which Coles commits to:

- good faith dealings and transparent commercial processes;

- transparent grocery supply arrangements;

- transparency around ranging and de-listing;

- respect the integrity of suppliers' businesses, and

- a fast-track, low-cost supplier dispute resolution framework.

Under this dispute resolution framework, Coles provides three alternative procedures for suppliers to resolve disputes with Coles:

- referral to a Dispute Resolution Manager who is independent of any Coles merchandise team and will respond to written complaints, conclude an investigation of the dispute within 15 business days and provide confidential reports to the Managing Director of Coles and the complainant setting out proposed steps to resolve the complaint;

- internal review by senior management under a Protocol that ensures a dispute can be elevated through senior levels of management as necessary for resolution to General Managers and ultimately the Managing Director, to be resolved within 15 business days; and

- referral to an Independent Arbiter for resolution, either directly or if a complainant is not satisfied with any of the other procedures. The Independent Arbiter can make a binding decision imposing a financial settlement of up to $5 million.

All of these procedures enable the supplier to address their concerns in a confidential way.

Coles has appointed Mr Jeff Kennett AC as the first Independent Arbiter under the framework and will bear the costs of complaints under the framework.

The Charter has helped Coles improve the parameters of best practice conduct for its buyers, provide clear expectations for its supply base and establish an accessible framework to manage any issues that might arise from its trading relationships in as expeditious and efficient a manner as possible.

Section Four: Competition and regulation

The Agricultural Competitiveness Green Paper highlighted the importance of competition and regulation to the sector. Competition is fundamental to improved performance and greater profitability.

Many of the competition issues raised in the Agriculture Green Paper overlap with the Government's Competition Policy Review including in relation to revisions to the Competition and Consumer Act, divestiture powers, dispute resolution and industry codes of conduct.

Coles believes that the Draft Report of the Harper Review Panel provided a constructive contribution to the debate on competition policy. It was timely in light of the Commonwealth's commitment to an innovation and competitiveness agenda.

Coles strongly supports the underlying principle that the interests of the consumer must always be at the heart of the competition policy debate. The entry into the market of new foreign owned retailers and the emergence of on-line competitors has changed the operating environment for many retailers in Australia. This means that businesses like Coles have to strive harder to improve efficiency and lower prices in order to deliver better value and choice to customers. Policies to encourage strong competition and productivity-boosting investment should be priorities for all levels of government.

The Agricultural Competitiveness Green Paper noted some stakeholder concerns with the market-power of intermediaries including processors and supermarket retailers and related issues around market concentration and imbalances in negotiating power between farmers, processors and supermarkets.

The Draft Report of the Competition Policy Review provided some analysis of the retail grocery market. It found that:

> 'Australia's grocery market is concentrated, but not uniquely so. While concentration is relevant, it is not determinative of the level of competition in a market. A concentrated market with significant barriers to entry may be conducive to weak competition, but competition between supermarkets in Australia appears to have intensified in recent years following Wesfarmers' acquisition of Coles and the expansion of ALDI and Costco; consequently, few concerns have been raised about prices charged to consumers by supermarkets.'[xxv]

Both the Harper review and the Agricultural Competitiveness Green Paper suggested a need to change the current misuse of market power provisions under section 46 of the Competition and Consumer Act on the basis that, at present, it is difficult to successfully prosecute potential breaches in the courts.

Coles is concerned at the Review Panel's proposal to amend significantly section 46 of the Act.

The Review Panel has recommended an entirely new section 46 of the Competition and Consumer Act that increases dramatically its scope. Essentially, a new effects test will act in unison with a substantial lessening of competition test – i.e., the new section would prohibit a business with market power from engaging in any conduct that has the purpose, effect or likely effect of substantially lessening competition.

The risk is that the combination of the two will make businesses wary about engaging in pro-competitive actions that benefit consumers but harm competitors. The changes may in future force businesses to defend pro-competitive conduct before the courts.

Coles has seen no evidence that the current section 46 is failing to capture any conduct that should be captured, and certainly no evidence that it is failing to capture any conduct that would be captured appropriately by the proposed section 46.

The proposed misuse of market power provisions including the proposed defences appear not to have been sufficiently developed or explained. This heightens the risk of unintended consequences.

Coles is concerned that the new prohibition and defences will increase uncertainty as to the risk of ACCC investigation and legal action and will result in less dynamic, less responsive and more conservative decisions by businesses that are considered to have market power.

In a tough operating environment characterised by increasing global competition, businesses have to strive to lower their costs and increase their productivity if they are to offer value to customers. Proceeding with the changes to section 46 as framed will add to uncertainty and will cut across the objectives of Government around sensible regulation and pursuit of a pro-growth agenda.

The Agricultural Competitiveness Green Paper noted that some stakeholders have suggested further changes to the Competition and Consumer Act to include a general divestiture power.

Coles supports the position taken by the Harper Panel on this issue – that proposals for a specific divestiture remedy are not warranted on the basis that 'divestiture is likely to have broader impacts on the general efficiency of the firm' and 'such changes could also have negative flow on effects to consumer welfare.'

The Green Paper has further highlighted stakeholder suggestions regarding the establishment of a supermarket ombudsman and a supermarket mandatory code of conduct. These issues were also discussed in the Draft Report of the Competition Review Panel.

The Panel provided a useful characterisation of the nature and benefits of industry codes, particularly how they play an important role under the Competition and Consumer Act by providing for a flexible regulatory framework to set norms of behaviour.

Coles considers that self-regulatory approaches such as industry codes assist in reducing regulatory burdens and red tape on businesses, as they can be appropriately tailored to apply broader principles and policy outcomes to a particular industry's circumstances. However, they can only be at their most effective if they include all relevant industry participants.

Coles has contributed to the development of the Food and Grocery Code of Conduct currently before the Commonwealth Government and is fully committed to that Code.

As outlined above, Coles works with businesses of all sizes and fully supports the development of alternative dispute resolution processes and other appropriate access to remedies for small business.

Coles does not consider that a specific dispute resolution scheme dedicated to issues arising under the Competition and Consumer Act is necessary or advisable.

Ideally these disputes would be addressed as part of an ongoing relationship between the parties, with a rigorous third-party arbiter or mediator where necessary.

Conclusion

This submission has highlighted the opportunities a successful and competitive agricultural sector offers for Australia, Coles and its customers and suppliers. It also outlines aspects of the contribution Coles makes to the sector through its partnerships with producers and suppliers and others through the supply chain.

It is clear that Australian agriculture needs to secure more capital investment if it is to increase its competitiveness and entrench itself as a best-in-class global producer.

Coles continues to work with its producers, often through long-term supply agreements, to help provide a foundation for future investment and expansion of the sector. In a competitive market there is no alternative but to seek out greater efficiencies and become more innovative if farm gate returns are to be strengthened.

Putting policy settings in place that support innovation and continuous improvement is the best way of securing a strong future for our agriculture sector and the regional communities that sustain it.

Coles continues to play its part through a focus on improving the efficiency of its end-to-end supply chain and helping its suppliers improve their performance as we strive to meet the expectations of Australian consumers.

Coles looks forward to working with the Government as it frames a policy agenda that will allow Australia's agricultural sector to achieve its growth potential.

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