4. Warning signs

In this Part of the report we canvas key regulatory and industry developments, as well as broader shifts in the macro-economic environment, from 2008 onwards and analyse how such developments served as early signposts to the likelihood that ultimately some action would be taken to regulate supermarket-supplier relations.

The ACCC Grocery Inquiry provides a useful starting point in examining the context in which the FGCC emerged. This is not to suggest that many of the issues grappled with in the inquiry were new. In particular, implications of MSC dominance for small to medium size grocery businesses (both retailers and suppliers) had been the subject of inquiries dating back to the early 1990s. However, the extent to which the inquiry's characterisation of competition in the grocery sector in 2008 remains true today, and for whom, or failed to foretell what was to come, are relevant considerations when tracing the development of the FGCC, and the form that that instrument took.

The inquiry's focus was on retail concentration and its consequences for competition and consumers in the grocery sector in both horizontal (as between retailers) and vertical (as between retailers and suppliers) dimensions. It is contextually significant because of its ultimate findings, namely that the sector at that time was 'workably competitive'[8] and there was nothing 'fundamentally wrong' in the supply chain.[9] However, despite the scope of consultation undertaken for and the detail provided in its 500-plus pages, the ACCC's report provided only a hint of future developments. The period immediately following the inquiry was punctuated by a series of forces and factors that would inflame MSC-supplier relations, drawing these issues further into the public and political spotlight.

In this Part of the report we begin by considering the impetus for and the main findings of the inquiry, together with the divergent responses to these findings of different stakeholders. While the MSCs were supportive of the generally favourable (for them) conclusions, some suppliers believed that the ACCC had missed the mark. Regardless of whether this criticism was valid at that time, it was not long before competition between the MSCs increased significantly, bringing with it direct consequences for vertical relations. We identify and examine the two key reasons for this: the Wesfarmers' takeover of Coles, which saw the previously languishing supermarket chain quickly and aggressively bring the challenge up to Woolworths, and the emergence of Aldi, the German discounting chain, as a major price competitor to the two dominant MSCs.

The amplification of horizontal competition brought with it cheaper prices for consumers but at the same time extra pressure on suppliers as the MSCs fought hard on market share and sought to temper the Aldi effect. We highlight these reverberations of retail competition in the vertical supply chain. At the same time we point to the significance of contemporaneous developments in the macro-economic environment and their effects. Almost immediately after 2008 the Australian dollar began to strengthen. By 2009 it had achieved parity with the US dollar, creating conditions where imports were

[8] ACCC 2008 Grocery Inquiry, p. 210.
[9] ACCC 2008 Grocery Inquiry overview, p. xiv.

increasingly attractive to the MSCs seeking cheaper stock while export markets for Australian manufacturers became increasingly challenging. The analysis further demonstrates that during this period the MSCs, Coles especially, was undergoing something of a cultural transformation. In an attempt to turn the company around Wesfarmers looked to the UK to fill key senior management positions. The UK grocery retail sector had long been a hotly contested market, and these new leaders brought with them aggressive negotiating and other supply chain strategies that had been employed successfully to squeeze the best deal out of UK suppliers.

As pressure on Australian suppliers mounted they found their political voice, not only behind doors in the Canberra corridors of power but also in mainstream media. We document these political rumblings and point out that, as a consequence, it was no longer sufficient for government to focus on ensuring the sector provided competitive grocery prices. The viability of Australian suppliers was under threat and 90% of these were small to medium size businesses. As the sector heated up the political implications of having two major supermarkets dominating the retail grocery landscape, and an increasingly unhappy supply chain, became far more complex.

I. The ACCC Grocery Inquiry

While tensions regarding the market size and power of the MSCs have been simmering for many years in Australia,[10] a crucial milestone in tracing key events and actors in the regulatory discourse that led to the FGCC is the inquiry of the ACCC into retail grocery prices which reported in 2008. The impetus was government concerns about inflationary pressures and political debate about costs of living. Thus the focus was squarely on the level of concentration and associated degree of competition between grocery retailers and, in particular, the question whether the largely duopolistic market structure was responsible for rising consumer prices.

After a substantial investigation, the ACCC produced a voluminous report in which it concluded that competition was 'workably competitive' and structural problems in the sector were overstated.[11] There was strong price competition on key value items, accentuated by competitive responses by the MSCs to the expansion of the global discounter, Aldi.[12]

The increase in grocery prices above headline inflation was found to be referable to factors other than the size and operations of the MSCs – supply and demand changes in international and domestic markets, increases in production costs and domestic weather conditions.[13] Independent retailers were said to be competing on convenience and service and, to the extent they were struggling to compete on prices, this was attributed to the pricing practices of the monopolistic wholesaler Metcash.[14]

[10] Such tensions can be traced back at least to parliamentary inquiries in the late 1990s. See, e.g., House of Representatives Standing Committee on Industry, Science and Technology (1997) *Finding a Balance: Towards Fair Trading in Australia*; Joint Select Committee on the Retailing Sector (1999) *Fair Market or Market Failure: A Review of Australia's Retailing Sector*.
[11] ACCC 2008 Grocery Inquiry, p. 212.
[12] ACCC 2008 Grocery Inquiry, p. 97.
[13] ACCC 2008 Grocery Inquiry, pp. 29-40.
[14] ACCC 2008 Grocery Inquiry, p. 144-45.

Moreover, the report concluded that there was nothing ‘fundamentally wrong’ with the grocery supply chain.[15] While the MSCs had significant buyer power, the competition between them prevented retention of a large part of the benefits from the wholesale prices they extracted; at least some of these benefits were flowing to consumers by way of lower prices.[16]

In relation to farm-gate prices for fresh produce the ACCC did not find any evidence to suggest that the MSCs were acting in an anti-competitive way when dealing directly with suppliers. While the bargaining power of the MSCs was strong in these instances, for a good proportion of fresh products, farmers were said to have the option of selling to export markets or wholesale markets (which in turn supply independent supermarkets, butchers and greengrocers). This was seen to lower the bargaining power of the MSCs.[17] The ACCC accepted that ‘many Australian farmers are suffering and low prices for their product may be a significant contributing factor’.[18] However, it was of the view that ‘the extent to which the market power of retailers contributes to this problem is limited’.[19]

For packaged groceries, the ACCC conceded that farmers receive a small percentage of the final price charged to consumers; however, it saw this as typically reflecting the other costs that arise in the supply chain, including capital-intensive processing, packaging, advertising, delivery and retailing.[20] The price that farmers receive for many agricultural commodities, particularly products such as sugar and wheat, is set by international supply and demand conditions. Further, while the buyer power of the MSCs may affect individual competitors adversely, the ACCC emphasised that its concern was to protect competition, not individual competitors, and there was no significant evidence to suggest that innovation or competition at the supplier level had been damaged.[21]

The ACCC also pointed out that consumers can benefit from buyer power in the form of lower prices and what is more, consumers constrain the choices that the MSCs make. Consumers do not readily accept all private label products, which therefore limits options and lowers the MSCs’ bargaining power in those areas.[22] For those producers that have strong brands with consumer loyalty, the ACCC concluded that there are unlikely to be any concerns about the bargaining power of the MSCs, as these producers hold ‘must have’ products for retail stores.[23]

In conclusion, the ACCC made a series of recommendations. However, owing to the Commission’s findings, giving the sector an almost clean bill of competitive health, the recommendations were not extensive and in some respects could have been characterised as no more than tinkering around the edges. Planning and zoning issues had been identified as a significant barrier to entry in grocery sector. The ACCC therefore recommended that all appropriate levels of government consider ways that decisions regarding the allocation of retail space for supermarkets, with a particular focus on their

[15] ACCC 2008 Grocery Inquiry p. xiv.
[16] ACCC 2008 Grocery Inquiry, p. 92.
[17] ACCC 2008 Grocery Inquiry, p. 308.
[18] ACCC 2008 Grocery Inquiry p. xx.
[19] ACCC 2008 Grocery Inquiry p. xx.
[20] ACCC 2008 Grocery Inquiry, p. xx.
[21] ACCC 2008 Grocery Inquiry p. xx.
[22] ACCC 2008 Grocery Inquiry, p. xxi.
[23] ACCC 2008 Grocery Inquiry, p. xxi.

impact on competition between supermarkets in a given area, may or may not be facilitating the entry of new supermarkets in to that area.[24] The ACCC also recommended the introduction of a mandatory, nationally-consistent pricing regime for standard groceries be introduced for 'significant supermarket stores'. [25]

The majority of the ACCC's recommendations were directed at the HCC. These included:

- a review of the CCA so as to provide for civil pecuniary penalties and infringement notices in relation to Part IVB provisions, thereby allowing for stronger enforcement mechanisms in relation to the HCC;
- amendments that would increase transparency, clarity and certainty around transactions in the supply chain;
- amendments that would allow for pooling and price averaging;
- the subsidising of costs by Government for parties involved in dispute resolution under the HCC; and
- the implementation of further education initiatives.[26]

Consistent with the wide divergence of views on most aspects of the supermarket debate, stakeholder views on whether or the degree to which the ACCC 'got it right' in the 2008 inquiry are sharply divided.

Some representatives from the independent retailer sector interviewed for this research are of the view that the ACCC got it 'totally wrong'.[27] However, there are also concessions by some that the terms of reference were narrow (with an arguably undue focus on pricing, and thus not directly concerned with considerations such as diversity and choice)[28] and that the Commission struggled to elicit sufficient evidence from suppliers. The impact of the latter is attested to in the account given by Graeme Samuel AC, Chairman of the ACCC at the time of the inquiry:

> *The problem was that individually, no one was telling us. So what we did was, we went out with a media release. We went out with private correspondence and we went out with me going on radio, saying, "We guarantee you, absolute confidentiality. "Just come and tell us."... No one told us...*[29]

Lack of information as the reason for lack of findings on certain matters in the inquiry is clearly

[24] ACCC 2008 Grocery Inquiry, p. 9.
[25] ACCC 2008 Grocery Inquiry, p. 14.
[26] ACCC 2008 Grocery Inquiry, p. 13.
[27] Transcript of interview, CEO of MGA, p. 15; Transcript of interview, CEO of an independent supermarket, p. 19.
[28] Transcript of interview, CEO of MGA, p. 15.
[29] Transcript of interview, Graeme Samuel, p. 11.

reflected in the conclusions of the ACCC's report:

> *Given the lack of detail in the allegations made and specific denials by well-informed growers, the ACCC considers it unlikely that this kind of conduct* [referring to unfair trading practices] *occurs otherwise than in exceptionally rare circumstances. If specific complaints are made, the ACCC would investigate the matter under the unconscionability provisions of Part IV of the Trade Practices Act. What is clear, however, is that some growers have concerns, legitimate or otherwise, in their relationships with the MSCs. In the absence of specific complaints, the ACCC will not be able to address these issues.*[30]

The most commonly cited reason for apparent supplier reticence to speak out against the MSCs, both then and since, was and remains fear of commercial retribution by their major buyers.[31] This, according to an ACCC official, could include a so-called 'supply holiday', that is, 'if you complain, if you make a nuisance of yourself, then your supply is cut off'.[32]

While such hesitance is mostly associated with small suppliers, others do not see it as so confined – as implicit in the remarks of a senior representative of AMWU': 'when you've got the likes of Coca Cola and Heinz and Mondelez and companies of that size that aren't keen to come out and speak against the supermarkets, to me that's got to ring alarm bells.'[33] That large suppliers would be just as, if not, more reticent than small suppliers to 'rock the boat' is borne out by the observations of John Noble, Director of British Brands Group, a representative association for large suppliers in the UK (where similar issues have plagued supermarket supply chains):

> *…talking about unfair trading practices – very, very few, even the largest suppliers would go to officials or MPs talking about unfair trading practices by their retail customers because that would be death to them. Everything with their retail customers is commercial, it's between us and them, it's confidential: "That's our business not your business, policy maker, keep your nose out.*"[34]

In explaining further why large suppliers take this stance, Noble told us:

> *The UK market is a huge market; the bigger you are the more you have to lose. It doesn't matter whether you have must-stock brands or not - I think there are relatively few must-stock brands anyway, and companies with them will have other products in their portfolio including small up and coming brands as well. The retailer has the power to target the*

[30] ACCC 2008 Grocery Inquiry, p. 252. Notably in its 2004 report on how the SCOP was working in the UK, the OFT appeared to have been plagued by similar difficulties in eliciting detailed information from suppliers about their grievances and concluded that '[t]his made it impossible to draw any firm conclusions as to how individual supermarkets are operating under the Code.' See OFT press notice 28/04, *OFT publishes supermarkets code review*, 20 February 2004. See also the CC's press notice in relation to progress in its 2006-2007 inquiry noting that while 'many general assertions [had been] made about the activities of and the power held by supermarkets' had been made, 'we have not received as much specific evidence about unfair treatment of suppliers as we might have expected.' Cited in Antony Seely, 'Supermarkets: competition inquiries into the groceries market' SN03653, 2 August 2012, p. 23.
[31] Transcript of interview, Gary Dawson, p. 15.
[32] Transcript of interview, senior representative of the ACCC, p. 13.
[33] Transcript of interview, senior representative of AMWU, p. 32.
[34] Transcript of interview, John Noble, British Brands Group, p. 17.

> *weaker brands saying, "Well I'm very sorry, I'm not going to take your promotion, I'm not going to take your new product," or "Yeah, well that's going down on the bottom shelf." … So even* [these suppliers are] *extremely vulnerable. And public companies are obviously more vulnerable than private ones, I would say. … You suddenly get de-listed – one of your big brands gets de-listed, your shareholders will know all about that.* (An ACCC official makes a similar point, citing an example of 'one enormously large supplier [who] came to us and basically said "our margins are such that if there is a decrease in our exposure in any one of these majors then we'll go backwards very quickly" ... so they're just as vulnerable.')[35]

However, as indicated by his comments cited above, Samuel AC has a somewhat different perspective on the 'real' reason for supplier reluctance to speak out, at least at the time of the ACCC inquiry. On his account, representative associations – particularly those representing primary producers – openly made assertions about harsh or oppressive tactics employed by the MSCs against their members. But when the ACCC sought corroborating information from individual suppliers, they encountered considerable stone walling or silence. The reason for this, according to the former Chairman, was that:

> *In fact, what they did do, was in Canberra, they said exactly the opposite. They said there is not an issue. And they said if we had a preference to dealing with anyone, it would be to deal with Coles and Woolworths, not to be dealing with Metcash and not to be dealing directly with the markets… none of them, in Canberra, in confidence, would – had a word, a negative word to say about Coles and Woollies.…they* [referring to individual suppliers] *didn't want to say publicly, we actually like dealing with Coles and Woollies, we don't have a problem with them. Yeah, "they're tough but fair" was the constant explanation given, "because if we do that, other suppliers are going to be irritable, because they're saying you are lessening our negotiating capacity, right?" Particularly in the political scene…the groups representing the growers, were out there arguing how bad and nasty Coles and Woolworths, as the major buyers, were. And so you* [referring to an individual supplier] *would be making statements, basically out of school, from the point of view of your colleagues.*[36]

While some retailer and supplier representatives are critical of the accuracy or completeness of the conclusions reached in the ACCC Grocery Inquiry, it is worth noting that the ACCC's findings were largely consistent not just with the submissions of the MSCs themselves but with the submissions from the peak supplier body, the AFGC. The AFGC acknowledged in its submission that, 'undoubtedly the market power of the retailers and wholesalers has increased'; however it viewed

[35] Transcript of interview, senior representative of the ACCC, p. 14.
[36] Transcript of interview, Samuel, p. 15. See also the statement in the ACCC 2008 Grocery Inquiry report '… there was very little in the way of specific evidence of harsh or unconscionable conduct by the MSCs, or specific incidents of apparent abuse of their market position by the MSCs. In fact, many growers and suppliers summonsed to attend the hearings by the ACCC provided positive reports about the conduct of the MSCs, which would not normally be brought to the public's attention' (pp. 326-7).

this as only underscoring the importance of suppliers having a healthy business relationship with 'all major retailers and wholesalers'.[37] While the AFGC conceded the disparity in market power, it stated that it was 'unaware of behaviour between trading partners which contravenes the provisions of the Trade Practices Act or for which amendments to the Act would improve the competitiveness of the system.' It concluded that 'a competitive food and grocery retail sector exists in Australia and operates to deliver competitive prices for the consumer'.'[38] Consistent in many respects with the subsequent findings of the ACCC, the AFGC attributed the challenges in the market to external factors such as drought and high international commodity prices,[39] the arrival of new players in the form principally of Aldi, and the increased vertical integration of the MSC supply chains.[40] It made no complaint relating to or even mention of fair trading or unconscionability-related issues or concerns in its account.

As discussed below, in the years following 2008 many of the ACCC's findings pertaining to competition at the horizontal level of the grocery market were borne out. In contrast, its assurances about supply chain relations appear, in hindsight, to have misplaced or, as some would argue, under-informed. In ensuing years, these concerns began to crystallise and the focus of official and public attention shifted firmly from the horizontal to the vertical dimension of the sector.

Developments post-2008 are traced in the sections that follow. While hindsight's benefit is to be acknowledged, those developments do suggest that the conclusions reached in the milestone inquiry warrant a mixed scorecard. As ruefully observed by one observer:

> *I think that the ACCC got it broadly right in 2008 because events have shown that left for itself, there was enough competition in the market … and it was probably less correct on the – not that it was less correct but there clearly was – there were issues in the supply chain..*[41]

II. Intensifying competition and external influences

Almost immediately after the ACCC Grocery Inquiry there were developments at the retail level of the grocery sector that saw a substantial increase in competition amongst retailers. The competition manifested in a significant fall in real food prices[42] (including outbreaks of price wars on staples such as milk, bread and eggs) and strong pressure on MSC earnings before interest and tax margins, as well as reports of financial difficulties for Metcash and its banner retailers, the Independent Grocers of Australia (IGAs).[43]

[37] AFGC public submission to ACCC 2008 Grocery Inquiry, 11 March 2008, p. 6.
[38] AFGC public submission to ACCC 2008 Grocery Inquiry, 11 March 2008, p. 3.
[39] AFGC public submission to ACCC 2008 Grocery Inquiry, 11 March 2008, p. 2.
[40] AFGC public submission to ACCC 2008 Grocery Inquiry, 11 March 2008, p. 11.
[41] Former senior representative of the UK OFT, p. 14.
[42] Just over five years on from the ACCC Grocery Inquiry, food and non-alcoholic beverage prices were tracking at 1.3% compared to inflation at 2.6%. See Woolworths Limited, 'Response to Competition Policy Review' (June 2014), p 15, citing Australian Bureau of Statistics (2014), table 7.
[43] Carrie LaFrenz, 'Watchdog urged to examine grocery market', *SMH*, 14 April 2008.

While there is likely to be a myriad of factors that contributed to this uptick in competition, one of the few matters on which all stakeholders in the sector agree is that two factors were particularly instrumental. The first was the turnaround in Coles's performance following its acquisition by Wesfarmers, and the second was Aldi's consolidation of its status as a serious player in the sector.

(a) The Wesfarmers turnaround

When Wesfarmers made the acquisition, in late 2007, the Coles business was in a parlous state. In September of that year, despite Coles' management suggesting that the ongoing sales decline had been stemmed, the general response from market analysts was far from optimistic. Credit Suisse announced that it had 'our FY08 down by 8.4 per cent in light of the lack of sales momentum and robust competitive environment'.[44] UBS went further, revising down its 2007-08 forecast by 16%.[45]

In the company's 2007 Annual Report CEO John Fletcher attributed the problems in Coles' supermarket division to the decision to rebrand Bi-Lo stores to Coles stores, saying that the execution of the initiative had been poor and did not deliver 'the planned customer value proposition'.[46] However news reports at the time indicate the division had been in 'state of upheaval' for at least the previous three years.[47] After the retirement of the company's long-serving supermarket CEO Alan Williams, in 2003 British executive Steven Cain was brought in, but stayed in the role just 14 months before being replaced by former Senior Vice President of Merchandising and Marketing at Wal-Mart in Canada, Hani Zayadi, who in turn soon was replaced by Peter Scott in March 2006. Scott was dismissed later that same year, allegedly for having unacceptable dealings with suppliers, including accepting gifts in return for favourable treatment.[48]

Coles' decline has also been attributed to a loss of customer focus as external pressures mounted. By 2007 Coles was not only struggling to achieve the profit targets Fletcher had announced to the market, but to match the big supply chain investments that Woolworths had already made. Having modernised its supply chain, Woolworths was sharing the resultant savings between its bottom line and lower supermarket prices. The effort that Coles was putting into restructuring its supply chain was said to have distracted from the need to maintain and increase investment in day-to-day operations so as to retain and increase its customer base. Macquarie Bank's Greg Dring was reported as suggesting that any profits Coles made at this time came at an unsustainable cost to service and quality.[49]

Archie Norman, the former chairman of Independent Television (ITV) and advisor to Wesfarmers on the acquisition and transformation of Coles by Wesfarmers, reportedly believed the acquisition succeeded in part because of the poor state of the business at the time:

[44] Elizabeth Knight, 'Few believe Coles story', *Brisbane Times*, 21 September 2007.
[45] Elizabeth Knight, 'Few believe Coles story', *Brisbane Times*, 21 September 2007.
[46] Coles Group Limited, *Annual Report* (2007), p. 3.
[47] Rebecca Urban, 'Coles sacks supermarkets executive over supplier deals', *The Age*, 18 November 2006.
[48] Rebecca Urban, 'Coles sacks supermarkets executive over supplier deals', *The Age*, 18 November 2006.
[49] Malcolm Maiden, 'Coles' slump teaches the lesson that long-distance relationships can be costly', *The Age*, 22 September 2007.

> *… the stores were dirty, the shelves were cluttered, queues were long and the head office bureaucratic. Typically, fresh produce was seven-to-eight-days old by the time it arrived in the store and shops held more than five days' worth of stock.*[50]

Others reflecting back recall too that there were 'egregious' inefficiencies in the supply chain, issues that just had to be tackled if Coles was to resurrect itself:

> *My perception is that in the period 2008 to 2012, there were just such egregious problems in the supply chain, with waste and other issues. If you talk to the people in Coles about what problems they were trying to solve, most of* [these] *problems were things that it was in everybody's interest to solve. For example, instead of somebody producing a pallet of goods, they produced a single box and send a whole pallet with one box on it, which is hugely inefficient. The retailer then wouldn't have the supplies in on the days they were supposed to have them in. This had a negative impact on consumers. So I think at that stage there was probably a need to get regularity and order into the system, so that when you said we're going to have Doritos on the shelf in 700 supermarkets ... that you actually have a system in place to deliver that, and not have it in 500 of them and 200 of them missing.*[51]

Following the acquisition, such was the turnaround under new leadership that, by 2013 Coles had outperformed Woolworths for 18 consecutive quarters, with revenue for the food and liquor business growing at a compound annual growth rate of 5.6% from $28.8bn in 2009 to $35.8bn in 2013.[52]

(b) The Aldi incursion

The German grocery chain Aldi, having begun as a collaboration between two brothers in the Ruhr region in the 1940s, had grown into a 'global retailing powerhouse' by 2011 with over 8000 stores operating in 20 countries across three continents, and ranking as the 8th largest retailer in the world.[53] However despite its size and success, relatively little is known about this very private company - a fact attributable to the extreme distain the company's founders had to any form of publicity. According to a close confidante of the family, they believed Aldi was successful because its management did not allow themselves to be distracted by the need to engage with the business press or the public.[54]

Former Managing Director of the company's Australian operations, Michael Kloeters denied the company was intentionally secretive. Instead Kloeters' is said to have attributed the company's repeated turning down of invitations for interviews or to attend industry events to nothing more than

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[50] Archie Norman, 'Against the odds Wesfarmers has taken Coles to the top of the supermarket tree', *SMH*, 29 January 2013.
[51] Transcript of interview, former senior representative of the UK OFT, p. 16.
[52] Richard Gluyas, 'How Ian McLeod turned Coles around', *The Australian*, 20 February 2014.
[53] Tom Osegowitsch and Markus Goelz, University of Melbourne case study, *Aldi in Australia*, October 2011 (Osegowitsch and Goelz, 2011), p. 4.
[54] S. Amann and j. Tietz, 'A secretive family's success. What makes Aldi discount empire tick', *Der Spiegel*, 3 March 2000, cited in Osegowitsch and Goelz, 2011, p. 4.

a lack of time on the part of Aldi executives.[55]

As an interviewee who consults to grocery businesses notes, Aldi is culturally different to the MSCs:

> *It just wants to run a supermarket and it is actually law-abiding and tries to assist where it can and do the right thing, and sends a very strong cultural message that, "we're just here to do our job and do the right thing," and really doesn't like the Australian environment in terms of … back and forth in the media, playing media games which its competitors do. It doesn't give political donations at all, it doesn't have lobbyists working for it. It doesn't have anything to do with any of that, it wants to just go about its role*.[56]

In 2001 Aldi entered the Australian market. Starting with two stores in Sydney, in its first five years it was able to secure only a small foothold in the market. However, from the late 2000s its investment and staying power began to show signs of paying off, such that by 2016, in the space of 10 years since 2006, its market share had almost tripled, from 3.1% to 12.5%,[57] with approximately 450 stores nationwide.[58] This was an outcome that may not have surprised Kloeters who reportedly said after studying Australia's markets and before agreeing to launch the company in Australia, supermarket operators 'had so much fat here in Australia. It was unbelievable'.[59] Aldi's strategy is almost entirely price-based. A lean and focused organisation that offers high quality but limited range, most of which are private label products,[60] Aldi is an aggressive discounter. At the time of the ACCC Grocery Inquiry, the competitive price pressure that Aldi was exerting on MSC pricing was more than evident.[61] By 2015, that pressure had intensified considerably – industry reports recording Aldi's prices on comparable products as 15% cheaper than its major rivals.[62] In late 2016 a Fairfax Media study of Aldi, Woolworths and Coles supermarkets in one suburb found that even on branded products such as Coke, Tim Tams and Weet-Bix, Woolworths shoppers were paying 12% more and Coles shoppers an extra 14%, when compared to those shopping at Aldi.[63]

However it is arguably in private label goods that Aldi has had the biggest impact on consumer spending habits, and with it the grocery supply market. Both Coles and Woolworths acknowledge that Aldi was the catalyst for change in this segment. While Australia, a country that had traditionally shunned private label products as unappealing and sub-standard, is still behind European and North American consumers in this area, Aldi has managed to convince consumers that private label does not necessarily mean lower quality. By 2011 private label sales made up 23% of all

[55] Osegowitsch and Goelz, 2011, p. 4.
[56] Transcript of interview, interviewee that consults to / advises grocery businesses, p. 13.
[57] J. Walker, 'Inside ALDI', *Business Review Weekly*, 17 July 2003, cited in Osegowitsch and Goelz, 2011, p. 5.
[58] Osegowitsch and Goelz, 2011, p. 14.
[59] J. Walker, 'Inside ALDI', *Business Review Weekly*, 17 July 2003, cited in Osegowitsch and Goelz, 2011, p. 5.
[60] Osegowitsch and Goelz, 2011, pp. 7-8.
[61] An extensive study of MSC local store pricing conducted by the ACCC found that consumers shopping at a Woolworths store with an Aldi within 1 km paid prices that were on average around 0.7 per cent lower than the prices paid by consumers at a Woolworths store without an Aldi within 5 km. And that consumers shopping at a Coles store with an Aldi within 1 km paid prices that were on average around 0.8 per cent lower than the prices paid by consumers at a Coles store without an Aldi within 5 km. The report concluded that Aldi appears to have a far more significant effect on MSC local store pricing across the products it stocks than a competing MSC. See ACCC 2008 Grocery Inquiry, p. 97.
[62] David Potts, 'Winners and losers in the trolley wars', *SMH*, 28 July 2015.
[63] Madeleine Heffernan, 'Woolworths, Coles, Aldi: which is cheapest for branded products?', *SMH*, 7 November 2016.

supermarket revenue in Australia, up 13% from 2000.[64] As the General Manager of Woolworths' private label division is reported to have observed, 'Aldi actually improved the quality stakes and kept the prices down'.[65] In response Woolworths upgraded 75% of its private label products, while Coles completely redesigned its entire range.[66] The two continue to rework and revamp these lines in an attempt to capture a share of the market that Aldi has invigorated.[67]

Aldi has a relatively simple, flat management structure. It has no marketing, public relations, human resources or legal departments, and instead relies on limited outsourcing. [68] According to Kloeters:

> *To save costs we don't have a public relations department. You can't be half pregnant; if you do a decent PR then it is going to cost you a lot of money – or you don't do it at all. It's very difficult to be in-between.*[69]

With regard to promotions, Aldi is said to shun 'marketing gimmicks', relying primarily on its website, hard copy catalogues and word of mouth.[70] In 2008 Aldi's Australian advertising expenditure was estimated at less than 0.5% of annual turnover.[71] The company does not offer loyalty programs or fuel discounts, with management reportedly stating that Aldi, 'prefers to focus on offering customers the best-quality products at the lowest possible price'.[72]

As a privately owned company, Aldi has the advantage of being able to make business decisions that may seem counter-intuitive or that will have a negative short term impact but positive long term benefits outside of the public spotlight and without having to answer to shareholders.[73]

As should be evident from just this brief description, Aldi introduced a whole new dynamic into the Australian grocery sector and its aggressive expansion heralded a shake up of the likes not previously seen since the MSCs had settled into their joint domination of much of the sector. The combined import of this development, together with Coles' turnaround, is neatly captured in this reflection on the period by a former AFGC CEO:

> *…very big changes occurred, well, really effectively just after that enquiry handed down its findings* [referring to the ACCC Grocery Inquiry]*, so you had the takeover of Coles by*

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[64] Private label growth was also affected by the global financial crisis, with Woolworths reporting a growth in sales at nearly double the rate of branded goods at this time, Eli Greenblat, 'Private labels set to fill more of every trolley', *Sydney Morning Herald*, 6 August 2010, cited in Osegowitsch and Goelz, 2011, p. 19.
[65] B Speedy, 'In-house labels a big hit for Coles', *The Australian*, 18 September 2010, cited in Osegowitsch and Goelz, 2011, p. 19.
[66] B Speedy, 'In-house labels a big hit for Coles', *The Australian*, 18 September 2010, cited in Osegowitsch and Goelz, 2011, p. 19.
[67] Osegowitsch and Goelz, 2011, p. 19.
[68] Richard Dunford, Ian Palmer and Jodie Benveniste, 'Strategy for successful entry into a concentrated and highly competitive market', in *Australian and New Zealand Academy of Management Annual Conference*, Australia, 7-10 December 2005, p. 8.
[69] J. Walker, Inside ALDI, *Business Review Weekly*, 17 July 2003, cited in Osegowitsch and Goelz, 2011, p. 5.
[70] Aldi website 2011, cited in Osegowitsch and Goelz, 2011, p. 11.
[71] S. Maseeha, P. Indu, D. Purkayastha, 'Aldi: The European hard discounter's strategy in Australia', ICMR Centre for Management Research, ECCH case 308-375-1, 2008, in Osegowitsch and Goelz, 2011, p. 11.
[72] . Maseeha, P. Indu, D. Purkayastha, 'Aldi: The European hard discounter's strategy in Australia', ICMR Centre for Management Research, ECCH case 308-375-1, 2008, in Osegowitsch and Goelz, 2011, p. 11.
[73] Richard Dunford, Ian Palmer and Jodie Benveniste, 'Strategy for successful entry into a concentrated and highly competitive market', in *Australian and New Zealand Academy of Management Annual Conference*, Australia, 7-10 December 2005, p. 6.

Wesfarmers, a very significant shift, coinciding with Aldi building a real presence, so they started here in 01 but was really only by 09, 10, that they were building influential presence. Both of those, I think, created quite a shift in the competitive reality at the retail level.[74]

A MSC representative described the 'Aldi effect' on the Australian retail grocery market in the following terms:

Aldi has reset expectations of value in the Australian market because up until then Homebrand was seen as kind of cheap and nasty quality and Aldi basically provided customers with a low priced alternative that was good quality, and so they have effectively reset how customers see value in the Australian context, so we have to be able to compete with that. We can't be seen as being really expensive relative to Aldi.[75]

It is notable that the incursion of Aldi and other discount chains such as Lidl have had a similar transformative effect in the UK, shaking up the traditional incumbents and changing consumer perceptions on value. Overall the impact has been to concentrate the minds of all retailers increasingly on price. As the head of the supplier organisation, the British Brands Group, recounted in his interview with us:

.. I think price has always been at the fundamental level of supermarket competition with the exception of Waitrose and Marks & Spencer's. Everybody else, price – you've got to win on price. And that was all going swimmingly I think for the big companies until the Aldis and Lidl came in with their much simpler business models and suddenly their low prices were looking positively high, and I think that penny dropped after the 2008, 2009 crash and I think here we were talking earlier about reputation, when you get that kind of a disparity in consumer pricing then people begin to think, "I always thought you were the cheapest but actually where's my money going?" I think there's been a big shift there, and I think once that shift takes place and certainly while Aldi and Lidl are always promoting their quality, so making the proposition that you're getting the same quality you had before but it is 20-30% cheaper, then people will stick with that proposition.[76]

(c) Vertical reverberations

The intensification of retail competition undoubtedly had ramifications up the supply chain, as the MSCs strove to make cost savings that would allow for lower prices and corresponding competitive advantage over rivals, but especially over Aldi and each other. Some of those savings were derived internally (through staff reductions, for example) but a large proportion of them involved being tougher in supplier negotiations on price, as well as demanding supplier support or compensation in various forms (for promotions, marketing, shrinkage or wastage, for example, or just to cover profit

[74] Transcript of interview, Gary Dawson, p. 18.
[75] Transcript of interview, MSC representative, p. 6.
[76] Transcript of interview, John Noble, British Brands Group, p. 10.

gaps), in some instances with threats of adverse consequences if demands were not met.[77] As one experienced grocery competition commentator observes, ‘if you’re in a very competitive industry and you want to be more cost competitive, you have to look at your upstream inputs, and the biggest input for the supermarkets is the cost of the food supplies that they buy’.[78]

It was noted by commentators around this time that the MSCs were requiring suppliers to make ‘payments above and beyond that negotiated in order to stock their products’, that they were imposing ‘penalties that do not form part of any negotiated terms of trade’; the MSCs were not paying agreed prices and they were discriminating in favour of their own home-brand products.[79] Along similar lines, in its submission to the Harper Review, the Australian Industry Group reported:

> *… very fierce bargaining over terms and conditions of supply and many* [suppliers] *feel they have little opportunity to push back on the dominant bargaining power of the larger supermarkets. For example, suppliers feel they have been coerced over time by the major supermarkets into supplying their branded product for supermarket private label product or not at all. This has the effect of negatively impacting suppliers’ capacity to innovate in the market, erosion of brand value and intellectual property.*[80]

This is not to suggest that MSC practices complained of during this period were in some way novel or new. Indeed, industry insiders point out that they had been part of the supermarket-supplier relational landscape for years.[81] A survey of growers conducted by the NSW Farmers Association in mid-2003 found that 60% of respondents feared raising a concern with the MSCs would invite commercial retaliation.[82] According to the MGA CEO, the MSCs have used their ‘market power, behaved unconscionably; knowing that what [they were doing] is damaging another person’s business …for 25 years’[83] - a claim underscored by a consultant to suppliers’ plea that, ‘we don't want expensive court cases, we just want the retailers to stop doing some of the things that for years have been deemed to be normalised behavior.’[84] However, there is also no doubt that as the going got tough amongst retailers in the late 2000s, it got even tougher for suppliers as a result. At the same time there were other factors at play, both in the broader economic environment and, internally, within the MSCs themselves.

(d) Macro aggravations

Former AFGC CEO, Gary Dawson, points out that what many official accounts overlook is that following the ACCC Grocery Inquiry there was a rise in the value in the Australian dollar in 2009 and

[77] Transcript of interview, Robert Hadler, p. 16.
[78]Transcript of interview, former senior representative of the UK OFT, p. 15.
[79] See, e.g., Christine Parker, ‘ACCC’s inquiry into supermarket bullying misses the real issue of duopoly power’, *The Conversation*, 19 February 2013.
[80] Ai (Australian Industry) Group submission to the Harper Review, June 2014, p. 51.
[81] Transcript of interview, CEO of MGA; ‘we’ve known it’s been going on for 25 years’, p. 3.
[82] Evan Jones, ‘The Australian retail duopoly as contrary to the public interest’, Report for the Fair Trading Coalition, Department of Political Economy, University of Sydney, April 2006, p. 23.
[83] Transcript of interview, CEO of MGA, p. 59.
[84] Transcript of interview, director of a consultancy that advises suppliers, p. 50.

2010, 'spiking to an over parity with the US dollar', and this had two effects.[85] First, 'it dramatically increased import competition at the same time as the retailers, led by Coles, were looking to source greater private label suppliers to compete with branded domestically produced goods.' Second, it 'choked off export markets dramatically for Australian FMCG manufacturers.'[86] So, Dawson concludes, 'you had a combination of intensifying price competition at the retail level at the same time as other structural factors [that meant] greater reliance on the major domestic retailers to shift product' and 'the intensity of that financial vice … was very very significant.'[87]

Some of the 'other factors' referred to by Dawson had been picked up in the AFGC's 2011-12 Annual Report, noting that the industry was facing a 'perfect storm' of pressures along the length of the supply chain. Such pressures not only included the high Australian dollar making imports significantly cheaper, but also near record high global commodity prices – sugar, dairy, cocoa, coffee, wheat; aggressive supermarket discounting; the increasing regulatory burden that was adding to compliance costs; complex and uncertain labelling requirements; and the introduction of the carbon tax.[88]

(e) Cultural shifts and UK influences

Some see the toughening in supplier negotiations in the post 2008 period as attributable to a cultural shift occurring within the MSCs during this time. This in turn is attributed by some to the increasing import and influence of senior executives from the UK where the retail grocery environment had been highly competitive for many years.[89] As explained by one senior industry insider:

> *…it had been coming for a while but it's almost like it was a tipping point around then* [referring to the late 2000s] *when it was no longer all about the handshake deal and no longer all about the: "I'm mates with my buyer, we'll go out drinking and we'll have a good time, we'll have this personal relationship". It became much more solidly commercial where it became like a battle of documents: "here's our documents which prove our side of the story, where's your captivating documents?" "Oh, come on, but we shook hands on it.' "No, where's your documents?" So it became a much more profit driven, much more hard business, much less good old boys' handshake type industry than it was. ... And, look, some of that of course was*

[85] By July 2011 the Australian Dollar had reached a high of US$1.10 (see Ausveg.com.au http://www.tradingeconomics.com/australia/currency). This was in part due to the on-going weakness of the US dollar, but it was also the result of elevated commodity prices, Australia's relatively high interest rates, and the preparedness of global investors to take on 'risk' in order to enhance returns in the very low-interest rate environment outside Australia. For trade-exposed sectors of the Australian economy, i.e. those competing in the export markets or at home against imports, this created obvious challenges (see Saul Eslake, 'Explainer: What a strong Australian dollar actually means", *The Conversation*, 11 April 2011.

[86] This point was made also in Senate Select Committee, *Australia's Food Processing Sector: Inquiry into Australia's food processing sector*, August 2012, [3.36].

[87] Transcript of interview, Gary Dawson, pp. 18-19.

[88] AFGC, *Annual Report* 2011-12, p. 3.

[89] Eli Greenblat, 'Metcash chief hits out at Coles executives', *SMH*, 3 March 2011; Blair Speedy, 'Coles raids UK retail talent pool for another chief', *The Australian*, 21 May 2009.

driven simply by the nature of the people who had been brought in to lead the organisations…[90]

The UK influence was especially notable in Coles' transformation.[91] The 'team of gun retailers'[92] (as they were referred to), assembled by Wesfarmers to rebuild the business, was headed up by Scottish-born Ian McLeod, who Wesfarmers' Chief Executive Richard Goyder had recruited from Halfords, a British car parts and bicycle retailer in May 2008.[93] Prior to his time at Halfords McLeod served as a Director of Asda and as a member of the WalMart Germany Executive Board.[94] The turnaround of Asda was credited to Archie Norman, the Chairman of ITV that advised Wesfarmers on the acquisition, and who remained in an advisory role to Coles for some time after.[95]

The turnaround strategy adopted by then Australia's reportedly highest paid CEO,[96] was very much based on the UK formula for retailer success, a formula of: 'slashing prices and shrinking shelf space to make way for their own home brands.' [97]

As former head of Kellogg Australia Jean-Yves Heude is said to have observed, the relationship between the MSCs and suppliers changed when Wesfarmers took control of Coles in 2008:

Before that, the way the industry was working was based on what I call the win-win model, where good relationships with people, long term relationships, not aggressive negotiation, was really the golden rule…[98]

However, according to Heude, once the executives from Britain were brought in to run things, aggression towards suppliers became the rule, leading to tougher negotiations on industry staples and discounting.[99]

McLeod said in an interview that the new strategy at Coles was directly responsive to both political and consumer pressures. On his arrival at the troubled business, he has reported, the feedback from both consumers and 'the government' (possibly a reference to the ACCC Grocery Inquiry) was that

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[90] Transcript of interview, Legal Director at the AFGC, pp. 19-20

[91] Although this was not the first time Coles had sought assistance from the UK. In early 2000 Steven Cain, who had been paramount in turning Asda Stores Limited around in the late 1990s, was brought in to aid the ailing retailer. Cain quickly implemented sweeping changes; merging back office operations, centralising business operations and reducing duplication – and with it staff numbers. Despite these achievements however it has been suggested that the pre-Wesfarmers bureaucracy and resistance to change within Coles at that time was the reason he left after just 14 months. See Gary Mortimer, 'Why Australian supermarkets continue to look to the UK for leadership', *The Conversation*, 20 January 2015. In discussing the recent addition of 'Tesco veteran Claire Peters' to the Woolworths team, Mortimer attributed the continued influx of British trained retail executives to our shores to 'the short sightedness of Australian retail management' and 'years of complacency.' He also noted Margarethe Wiersema's research of Fortune 1000 firms in the 1990s, which found that in periods of significant change, bringing in 'new blood' can help where an organisation is struggling with innovation and the need for strategic change. The challenge for Australian MSCs, according to Mortimer, is whether they are willing and able to embrace those changes.

[92] Miranda Devine, 'The big squeeze on small business', *Herald Sun*, 27 November 2011.

[93] Tony Boyd, 'How McLeod turned Coles around', *AFR,* 25 September 2010.

[94] Ian McCleod, executive profile, Bloomberg https://www.bloomberg.com/research/stocks/private/person.asp?personId=24928098&privcapId=32606641

[95] Gary Mortimer, 'Why Australian supermarkets continue to look to the UK for leadership', *The Conversation*, 20 January 2017.

[96] Miranda Devine, 'The big squeeze on small business', *Herald Sun*, 27 November 2011.

[97] Miranda Devine, 'The big squeeze on small business', *Herald Sun*, 27 November 2011.

[98] Andrew Robertson, 'Woolworths under fire from suppliers as ACCC court action proceeds', *ABC News*, 12 February 2016.

[99] Andrew Robertson, 'Woolworths under fire from suppliers as ACCC court action proceeds', *ABC News*, 12 February 2016.

prices were too high.[100] Hence, 'the first move' in the turnaround plan was 'to increase operational efficiency in order to invest in lower prices'.[101] Referring to the ACCC's findings, he explained:

> *… the investigation concluded that the sector was workably competitive. Three or four years later when we started to change our price position, it was described as ''intensely competitive''. That is because part of our underlying strategy to turn Coles around was to lower prices.*
>
> *Australia had endured annual food inflation of between 4 and 6 per cent for the best part of 30 years prior to the change of ownership in Coles in 2007. And because we sharpened our prices and pushed harder for the benefit of the consumer, we turned food inflation into food deflation, saving the consumer about 1bn Australian dollars a year.*[102]

(f) Political rumblings

As a result of the confluence of these developments, one of the key features of the years following the ACCC Grocery Inquiry was that, whereas previously there had been reticence by suppliers (for whatever reason) to speak openly against the MSCs, supplier discontent began to be heard increasingly in Canberra. In political terms, the problem was no longer about high grocery prices and the costs of living for consumers, but about the harsh commercial reality facing, and in some respects the very survival of a large proportion of Australian small business operators in the grocery sector. The proportion of small businesses in this sector is higher than in any other sector of the economy – almost 99% of Australia's food processors and wholesalers are small to medium sized enterprises.[103]

According to one former senior Coles executive, during that period:

> *.. it wasn't consumers per se that were complaining about supermarkets, it was the small business supplier. You know, in the environment of a higher dollar and sluggish demand, that really saw their margin squeezed, that led to a lot of the complaints. So it was the macro-economic factors, which they couldn't influence, which were driving them to the wall. But they sought protection from that, the only lever they had, which was to go to the government, say "you've got to do something about the supermarkets".*[104]

These voices were heard loud and clear in the public and political arena. One explanation given for this by a MSC representative is that when small businesses are affected by market dynamics, there is 'a lot of emotion' involved. It is not as if large suppliers are 'any less passionate about their businesses' but, he ruefully remarked, 'to a small supplier, take their product out of the range, it's like

[100] Mike Dawson, 'Talk with Coles legend Ian McLeod', *German Retail Blog*, 4 December 2014.
[101] Mike Dawson, 'Talk with Coles legend Ian McLeod', *German Retail Blog*, 4 December 2014.
[102] Mike Dawson, 'Talk with Coles legend Ian McLeod', *German Retail Blog*, 4 December 2014.
[103] Bruce Billson, 'Speech to Committee for Economic Development of Australia Lunch' (Speech, Melbourne, 9 May 2014).
[104] Transcript of interview, Robert Hadler, pp. 9-10

killing their babies ... and that's why you get much more public awareness and noise'.[105] Another MSC representative pointed out that the media plays a crucial role in this dynamic:

> *…the media's very powerful in the retail sector and …* [in] *bringing select issues to the fore and, of course, interest groups are very well aware of that …* [I]*n a smaller market the media people that cover this area, the politicians that cover it and the interest groups are a lot smaller and so it's easier, I think, to synthesise things into key messages and pick an interest group or a voice that can really get that, I suppose, amplification quite quickly in this sector and the general population is very, very interested in it.*[106]

By contrast, she pointed out, it is difficult for the MSCs to get their own 'voice' heard in the media in the same way, and in particular, a voice that enables them to bring to public attention their initiatives in supporting small suppliers, including farmers:

> *…often our media people say it's not in our interest to put across our view as our own view, we can speak as a collective through other industry bodies ... and I find that a shame but because a supermarket is perceived straight away as a powerful, I suppose, corporation that is probably simply profiteering that – although people love Coles and Woolies as supermarkets, they love shopping there, they don't want to hear their voice in the media in that way ... the advice we get is that it will be viewed cynically no matter what we say.*[107]

However, it wasn't just 'macro-economic factors' responsible for the growing chorus of supplier discontent. It is undeniably also the case that in the five years after the ACCC reported on the sector, the intensification of competition led the MSCs not only to get tough in their negotiations but also to rationalise their number of suppliers. Suppliers were not only being hurt, they were being eliminated. As McLeod rather understatedly recounted in 2014:

> *We have had to rationalise our supplier base by around 20 per cent over the last five years because we carried several thousand too many products on our shelves. Obviously some will have benefited from this decision, and others will have lost out.*[108]

Adding, in response to a question about supplier bitterness towards Coles:

> *Also, I guess that, if you are a big player in a market place, then you are inevitably going to be subject to a degree of criticism.*[109]

The difficulty for policymakers and the political challenge in this environment was and will remain that while intensified retail competition meant a harder life for some suppliers, there were others that were benefitting and, inevitably, it was only the voices in the former camp that were being heard in the call for action:

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[105] Transcript of interview, MSC representative, p. 24.
[106] Transcript of interview, MSC representative, p. 7.
[107] Transcript of interview, MSC representative, p. 18.
[108] Mike Dawson, 'Talk with Coles legend Ian McLeod', *German Retail Blog*, 4 December 2014.
[109] Mike Dawson, 'Talk with Coles legend Ian McLeod', *German Retail Blog*, 4 December 2014.

…for every supplier who complains about losing a contract, there's at least one more supplier that's so busy hiring people, building plans and doing other stuff that they don't have time to talk to anybody let alone complain, whereas the people who do not win the contracts are less busy and very disgruntled. So you get this asymmetry, because supermarket prices have been falling, sales have been going up. My understanding is that the percentage of Australian produced food and groceries has gone up… as a result of this increased competition. And they may be busier at lower prices, but they're still busier, and therefore there's a good news story about that competition that's often missing from public comment on the sector…[110]

[110] Transcript of interview, former senior representative of the UK OFT, p. 15.