

## 1. Introduction

The size and power of Australia's major supermarket chains (MSCs), Coles and Woolworths, have been the subject of sustained public debate and controversy for over a decade in Australia. Initially much of the concern was with harm to horizontal competition in grocery markets, that is competition as between retailers, and attendant consumer detriment, mostly by way of the prices paid at the check-out counter and, albeit to a lesser extent, the range of choice on the supermarket shelves. Standard micro-economics would suggest that a largely duopolistic market in which two firms enjoy a combined 60-70% share of sales in a substantial proportion of product categories, barriers to entry are relatively high and customers and suppliers have minimal countervailing or bargaining power, the result will be anti-competitive one – the market will not function effectively and consumer welfare will be diminished accordingly.

Yet at least two major independent inquiries into the sector, in 2008 and 2015, concluded that notwithstanding the high level of concentration, competition is generally working as it should and consumers are benefitting, at least in the short run. Correspondingly, while enforcement scrutiny has intensified in the last five years particularly, regulatory intervention in relation to competition has been fairly light touch, and largely directed at ways in which to reduce barriers to new entry and expansion of recent entrants. The prevailing view in policymaking and enforcement circles has been that, left mostly to its own devices, the 'invisible hand' of the market will be effective in delivering desired outcomes for consumers.

Despite this apparently high level of official comfort with allowing market forces to take their course, there has been no abatement in public and stakeholder agitation regarding the power of the MSCs – if anything, since 2008 industry concerns have escalated. To a large degree the more recent focus has been on vertical issues and specifically on the way in which the MSCs transact with and treat their direct suppliers. In particular, there has been a focus on MSC extraction of terms and conditions seen as involving an unreasonable transfer of risk and a squeeze on margins that dampens incentives for innovation and investment and prompts consolidation (and thus concentration) in some parts of the supplier base. In addition to the adverse implications for direct suppliers and, in the long run potentially for consumers, the flow on effects for indirect suppliers – primary producers especially – has garnered substantial attention. In the process, much of the blame for the struggles of Australian farmers has been levelled at the MSCs.

These concerns culminated in the introduction of a statutory code of conduct regulating supermarket-supplier relations in 2015 – the Food and Grocery Code of Conduct (FGCC). The Code is voluntary but only insofar as it does not apply compulsorily – retailers (and wholesalers, to which the provisions extend) can choose whether or not to agree to be bound. However, once signed up, the obligations are legally enforceable. Thus far, the MSCs, together with Aldi and a small retailer (About Life), have volunteered to be bound by the FGCC.

On any measure, the FGCC is a highly prescriptive regulatory instrument, influencing at least and in some instances dictating the approach taken to almost every aspect of the commercial relationship between the signatories and their suppliers. It imposes a not insignificant compliance burden and, some would argue or hope, cultural change on the MSCs and it also introduces a formalistic multi-tiered process for dispute resolution. The Code is enforceable by the Australian Competition and Consumer Commission (ACCC) in proceedings that would entail intrusive investigation, unwelcome publicity and substantial reputational fall-out for the accused code-breaker, and a range of formal orders even if (currently) the formal sanctions do not involve financial penalties.

If the market is working and consumer welfare is secure (at least in the short run), the advent of such regulatory intervention demands interrogation. This is particularly so given that there may be some support for the view that the code could in fact undermine competition by its uneven application across retailers and wholesalers, by weakening the drive for greater efficiencies in grocery supply chains, thereby undercutting achievement of the very policy objective at which the official attention has been mostly directed in the context of this sector. It warrants investigation even more so given that regulation of business conduct, at least to this degree, may be difficult to reconcile with the free market philosophy that underpins competition policy.

What is more, for some time now business, both big and small, has been pressing for and the government has promised to deliver further deregulation and the reduction of 'red tape' in the interests of increased productivity and economic growth. In this particular instance it was in fact the MSCs that took the regulatory initiative in proposing an enforceable code and drafting much of its content. In effect, the regulated turned regulators and in what could be seen as an astonishing and unprecedented exercise in collaboration and cooperation between two otherwise fiercely competitive and culturally different businesses.

Moreover, the MSCs were effective in co-opting government into the project, producing a co-regulatory instrument with objectives, terms and procedures defined largely by its industry authors but with legislative status and public oversight of its enforcement. The regulatory process thus exhibited an alignment of interests and convergence on norms between powerful private and public actors. Furthermore, the process was not just validated but arguably facilitated by the peak supplier body, the Australian Food and Grocery Council (AFGC), that organisation having convened a Retail-Supplier Roundtable (RSR) with the MSCs to offer up with a solution to the problems besetting the sector. Thus, from a regulatory studies perspective, the FGCC provides a fertile case study not only of the reasons for and outcomes of regulation but also of the processes by which regulation is formulated and the impact in turn of those processes on its legitimacy and effectiveness.

This report is based on research that has probed systematically the background to and developments leading up to the FGCC's introduction and, although it has been in effect for only a relatively short time (just over two years as at the date of this report), the way in which the code is perceived to be and is working in practice. The report draws on a broad range of primary and secondary sources from an extensive public documentary record. It is also informed by in-depth interviews with a large number

of stakeholders from across the grocery sector, related private and government organisations, and civic society.