INDEPENDENT REVIEW OF THE FOOD & GROCERY CODE 2023-24:

Submission to the Consultation Paper

February 2024

Summary

Australian Grape and Wine Incorporated (Australian Grape & Wine) welcomes the opportunity to present its opinion that the wine industry would benefit from inclusion in the Food and Grocery Code of Conduct (the Code).

There are over two thousand producers and approximately six thousand grape growers, a vast majority based in regional Australia; for some their businesses are also their family homes. Ensuring fair and equitable business practices exist throughout the supply chain is essential for the ongoing prosperity of all these businesses, especially the small and medium sized enterprises (SMEs). Although there are several large players, most wine and winegrape producers fall under $10m turnover. Downstream of the supply chain, in the liquor retail industry the level of concentration is much higher. As stated in the consultation paper, the four largest retailers (Endeavour Group, Coles, Metcash and Aldi) hold a market share of almost 70 per cent, with Endeavour and Coles alone having 55 per cent market share. [1] This has, and continues to, increase as consolidation continues.

Like many other agricultural industries, this structure often gives rise to producers undertaking commercial negotiations with substantially larger businesses. This occurs both within the winegrape market and the wine wholesale market. Any associated challenges impacting wine producers flow directly to growers.

Contraction of the wine export market following the loss of the China market has exacerbated the reliance of wine producers on the domestic market and their demand side risk. Both grape growers and wine producers suffer significant lead times and decisions regarding production often occur many months or even years before the product is sold. The ACCC in their Winegrape Market Study (2019) acknowledged the significant risk that winemakers bear in their dealings with buyers due to lack of certainty regarding volumes and pricing, particularly where they suffer the risk of products being de-listed at short notice.

A growing challenge is vertical integration of wine retailers into the supply chain including ownership of vineyards as well as wine production, storage, and bottling facilities. Retailers can either grow and make wine themselves, purchase wine in bulk and then bottle what is referred to as a 'buyers' own brand' or they can carry private label products exclusively available at their stores. With some of these businesses now owning hundreds of different brands from both Australia and overseas, for many winemakers the retailers are now both their major customer and their major competitor. Based on market research, industry estimates that supermarket own brands account for at least twenty per cent of wines sold in Australia by volume. [2] The impact this has on competition is discussed in the submission.

The high concentration level in the wine retail sector has been partly facilitated by the ease in which liquor retailers can vertically integrate and/or acquire more retail establishments under Australian Consumer Law. Consolidation of wine retail over the last two decades has changed and continues to change the operating environment for many wine producers. With the wine retail oligopoly enjoying the ability to buy bulk wine at distressed prices, winemakers report of an ongoing struggle to protect the brand values they have built over decades.

To optimise production efficiencies and spread costs, wineries ideally operate at full capacity. This can result in the need for large volumes of excess production to be diverted towards the global wine glut of low value commoditised wine. At this end of the market, Australian wines are readily substitutable with those from lower cost trading nations. Growers selling fruit destined for these unprofitable markets report that they are not recovering the variable cost of production.

Low pricing is a common complaint throughout the supply chain for wine. Although this alone is not considered unfair, when combined with practices that introduce uncertainty such as de-listing products at short notice or

[1] IBISWorld, Industry Report G4123 Liquor Retailing in Australia, IBISWorld, 2023, p. 10.
[2] Pers comms. Wine Australia (2024), market research included CGA/Nielsen and Circana

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unforeseen requirements for wine producers to contribute to retailer trade spends, businesses become more sensitive to the impacts of margin erosion. The Food and Grocery Code contains several related protections that would afford some advantage for producers.

This submission will provide further insight into the wine wholesale market, including industry concerns and the potential benefits of inclusion in the Code. It will also raise some questions that would require consideration if wine is recommended for inclusion. A selection of questions posed in the consultation paper have been addressed. Given that wine has not traditionally been covered within the Code, it did not seem appropriate to speculate on questions that would require assumptions. Thus, questions that required past experiences with this Code have been excluded.

Question 1. What, if other objectives should guide the Code to improve relations between supermarkets and their suppliers?

The Code should continue to address imbalances in bargaining power between major supermarkets and their suppliers. This should be extended to include wine producers who transact with similarly powerful liquor retailers and supermarket chains that sell wine. Australian Grape & Wine agree with the four legislated objectives as outlined in the consultation paper being:

1. To help to regulate standards of business conduct in the grocery supply chain and to build and sustain trust and cooperation throughout that chain;

2. To ensure transparency and certainty in commercial transactions in the grocery supply chain and to minimise disputes arising from a lack of certainty in respect of the commercial terms agreed between parties;

3. To provide an effective, fair and equitable dispute resolution process for raising and investigating complaints and resolving disputes arising between retailers or wholesalers and suppliers; and

4. To promote and support good faith in commercial dealings between retailers, wholesalers and suppliers.

There would be merit in adding a fifth objective aimed at ensuring consumers are well informed when they make purchasing decisions. Consumers are unable to easily identify private label or buyer own branded products. These products are thought to hold a significant and growing share of the domestic wine market and often have a look and feel reminiscent of those made by boutique wine businesses.

Traditionally when own-branded products are sold in supermarkets, it is understood by the consumer that the supermarket has the ability to cut or eliminate costs in distribution, marketing and advertising and so associated savings will be reflected in the price. There are countless studies that show consumers will pay a price premium, not just for quality but for brands they trust. Furthermore, products carrying supplier brands (as opposed to private and buyer owned brands) are generally also afforded a premium due to their association with quality and prestige. A certain cohort of consumers go so far as to factor support for smaller brands and/or family-owned brands into their purchasing criteria.

Issues with buyer own-brands and private labels extend beyond the lack of transparency impact on consumers. Major retailers can manipulate store layout and product placement and use various other forms of "choice editing" to afford their products a competitive advantage over those of their suppliers. This accords strong potential to lead consumers towards choices they might not otherwise make. In doing so it denies equally efficient competitors of access to a sufficient customer base, meaning they battle to remain competitive. The negative impact on producers and consumers can snowball as private brands increase market share, competition dwindles and impacts on consumers escalate.

With liquor retailers seeking to sell more of their own products there is a significant margin squeeze on producers that rely on these channels. Producers, and particularly small producers, are prone to information asymmetries as they lack visibility over the domestic market. They have little insight when an alternative wine style or variety is taking off in the market nor about how their products are performing compared to others in the relevant category. This leads to bargaining power imbalances during pricing negotiations and when considering whether they wish to fund promotions, and it means they tend to bear a disproportionate share of demand side risk. Market power imbalances are almost certainly a significant contributing factor to the downward pressure on both wine and winegrapes and growers are being hit particularly hard.

Question 3. Is it agreed that there is an imbalance in market power between supermarkets and all suppliers, or only some suppliers and/or some product types?

Imbalances in market power are likely to be having an impact across the sector, albeit to varying degrees. Larger wine producers, including major international wine importers, may be less affected than SMEs although the evidence is not clear. Some small producers who do not supply large retailers claim to be exempt from any immediate challenges however these producers may face a glass ceiling in their growth once direct to consumer sales or to small independent bottle shops and restaurants reach a saturation point. Many will find they lack the ability to scale up sufficiently, or the systems required to meet the rigorous demands of major retail chains.

Question 4. Should the same rules apply to all supplier interactions covered by the Code, or should additional requirements apply where a greater power imbalance exists?

The usefulness of regulation must be considered on balance with careful consideration of the unintended consequences that might arise. Therefore, in the wine wholesale market, it would be appropriate that additional requirements apply to larger retailers as this is where a greater power imbalance exists.

An unintended consequence of new regulation impacting wine retail across the board could be the loss of smaller independent retailers. These are a key sales channel for many small wine businesses who are not of sufficient size to export or to become a listed supplier of the major retailers.

A further risk associated with measures that are too restrictive on trade would be to promote vertical integration and/or encourage buyers to alter their trading practices to avoid transacting in parts of the supply chain that are covered under the Code. This could see further increases in buyers' own branded products.

The Code could only be mandatory for retailers (and potentially other parts of the supply chain) over a certain size or market share. Alternatively, or additionally, it could have mandatory components and voluntary components.

Question 6. [3]Should some or all alcoholic beverages be included in the scope of the Code?

The wine sector is broadly supportive of inclusion under the Code. Some producers, particularly those who are heavily exposed to sales channels involving major retailers, see significant potential benefits in joining the Code in terms of potential to increase transparency and/or accountability on issues such as delisting, promotional spends and shelf space allocation. However, we remain cognisant to the fact that there are multiple components to this review and the sense that we might be venturing into uncharted waters means that further consultation via our organisation would be appropriate.

We hold the view that inclusion of wine should not be contingent on inclusion of all liquor. Whilst we are not opposed to inclusion of other liquor we do not believe there is any reason that it need be "all in or none in". Wine is unique in that the vast majority of the eight thousand industry participants that rely on a competitive and resilient wine sector are primarily involved in growing grapes, with strong connections to their land and their regions.

Question 5. Should the Code be extended to cover other aspects of the food and grocery supply chain?

If a decision to include wine in the Code is supported, the wine sector would be willing and eager to engage in this debate. There is a general view amongst wine producers that the sectors' voluntary Code of Conduct for Winegrape

[3] Questions 5 and 6 have been reversed for logical flow of information

Purchases has the part of the supply chain between growers and processors (wineries) covered and that it is functioning effectively in setting appropriate standards. [4] There are certain cohorts of grape producers that do not share that view, primarily due to the behaviors of producers who are not signatories

If this review were to lead to a Code that incorporates processors into the supply chain, it may dampen the enthusiasm to include wine amongst some wine producers who do not see the need for further regulation of the winegrape market.

Question12. What dispute resolution model would most effectively facilitate positive outcomes for the industry, while also allaying suppliers concerns of retribution?

Although wine has not yet interacted with this Code, issues relating to fear of retribution are apparent across the supply chain. The problem occurs in parallel to a lack of faith that there will be anything to gain from raising a dispute. The situation would be improved through providing the ACCC infringement notice powers along with greater ability to enforce compliance through civil pecuniary penalties.

Question 13. What benefits could a mandatory code bring to suppliers?

The structure of the wine retail sector being highly concentrated gives rise to commercial negotiations between small businesses and substantially larger businesses. Associated challenges impacting wine producers, flow directly to growers. Benefits of joining the Code would reflect those outlined in the objectives of the Code. These include reduced imbalances in bargaining power and increased trust, cooperation and transparency. There would be potential for improved competition between supplier and the supermarkets' own branded products.

14. If the Code were made mandatory, what should be the threshold for supermarkets to be included in the Code?

The majority of concerns raised have involved the largest retailers that hold significant market share. An appropriate threshold would capture those holding 10% or above of the domestic wholesale market (inclusive of their own branded products). There would be an expectation that any regulation placed on larger businesses will have positive trickle-down effects on behaviors of smaller businesses who also compete with the major retailers to secure their supply base.

Question 15. Would it be possible to keep all, or some, of the arbitration model of the current Code if it were made mandatory? If so, how?

The arbitration process could be included as a voluntary component so as to avoid the issue of infringing the separation of powers doctrine under the Constitution.

Background – why was wine not included from the beginning?

The question as to why wine is not already included in the Code is not entirely clear. The 2018 Independent Review of the Code implied that wine producers didn't suffer enough from market power issues as they had access to other revenue streams, such as export markets, and particularly the rapidly growing Chinese market. [5] At the time major retailers made up only 23.4% of the total wine market. This situation has since changed. In 2016 ACCC stated that winemakers did in fact want to see alcoholic beverages included in the Code when it was next reviewed. [6] Lack of

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[4] https://www.agw.org.au/wp-content/uploads/2024/01/Code-of-Conduct-September-2021-v2.4.pdf
[5] https://treasury.gov.au/sites/default/files/2021-08/Independent-review-of-the-Food-and-Grocery-Code-of-Conduct-Final-Report.pdf
[6] Perspectives in horticulture and viticulture industry Views on competition and fair trading issues 27 October 2016 https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.accc.gov.au%2Fsystem%2Ffiles%2FPerspectives%2520in%2520horticulture%2520and%2520viticulture.DOCX&wdOrigin=BROWSELINK

pressure from winemakers in more recent times for the inclusion of wine could be attributed to subsequent negative commentary about the Code - mainly related to its voluntary nature, the low level of complaints in comparison to the level of concerns amongst suppliers and the lack of sanctions.

Overview of the wine supply chain

As the wine sector continues to suffer the economic shock that came from losing the substantial China export market, many businesses throughout the supply chain are under unprecedented levels of economic stress. As suppressed retail and wholesale pricing filters down the value chain, the approximately six thousand small business operating in the market for winegrapes tend to be hit first and hit the hardest. Low prices are also a function of a downturn in the global market for wine. Hard bargaining due to power imbalances will make it difficult for producers to increase their prices if the situation improves as has been seen through the lack of price increases in response to increasing input costs. The low profits are adding fuel to any concerns that risk is being unfairly allocated upstream.

A prevailing challenge for many agricultural businesses and especially those in the wine sector is that business must make production and sales decisions well in advance of information about price and market conditions. Capital assets are often owned and operated for a length of time before becoming profitable for the investor. For this reason, where a processor would need to make a significant capital investment to be able to manufacture a product, they may require a long-term contract with a retailer, to facilitate a return on the investment. The same may apply in some processor-producer relationships where the producer needs to make similarly significant capital investments well in advance of gaining a return.[7] The ACCC's Perishable Agricultural Good Inquiry report highlights problems within agricultural supply chains, discussing the issue above in the context of information failures. The submission has highlighted the information asymmetries between producers and retailers who continue to vertically integrate and/or release more and more own branded products.

Through the Code of Conduct for Australian Wine Grape Purchases many winegrape growers are offered protection on matters unique to the wine sector that are not covered under Australian Consumer Law. Our Code remains voluntary and being industry led, does not provide for penalties. When the ACCC conducted their Winegrape Market study in 2019, the two representative bodies under the Wine Australia Act were Wine Grape Growers Australia (trading as Australian Vignerons) and Winemakers' Federation of Australia. Both agreed that there was scope to strengthen the Code and improve its coverage. At that time, there was a lack of evidence of industry-wide support for further regulation through a mandatory code due to the often-restrictive nature of mandatory codes and concerns that excessive regulation would deter producers from entering into supply contracts with growers. Since the two former peak bodies came together in 2019 to form Australian Grape and Wine there have been significant amendments to the Code resulting in some improvements in the winegrape market.

There are challenges with regards to regulating wine markets, particularly the winegrape market. Unlike typical agricultural commodities, wines and the grapes they are made from are highly differentiated products that can command significantly different prices, sometimes well in excess of production costs. There are over one hundred and sixty different winegrape varieties grown in Australia in sixty-five Geographical Indications (regions) and within each combination different vineyards grow grapes of varying grades. This creates ambiguity with respect to how winegrapes are priced. Many of the characteristics that make certain grapes and wines superior to others are quite subjective. These less quantifiable characteristics encompass wine's diversity, arguably its most important attribute, and what makes it so highly sought after by consumers. It is this same very attribute that can lead to challenges when making wine or grape quality assessments for the purpose of affecting price. Some degree of pricing ambiguity is broadly accepted, particularly in the ultra-premium wine market where growers trust buyers to assign

[7] ACCC (2020) Perishable Agricultural Goods Inquiry Report p10

prices based on winemaker grades of the vineyard or the resulting wines. The ability for producers to achieve significant profits from producing superior quality promotes innovation and generates healthy competition. However, towards the more commoditised end of the market pricing becomes more competitive and in turn is likely to be questioned for lack of fairness.

Despite these challenges, the industry expects to see further improvements in commercial practices in response to the recent strengthening of unfair contract term legislation. It is hoped that this, along with the unfair trading practices review, will address residual issues in the winegrape market and either discourage or put an end to lengthy payment terms. The competition review and the various supermarket inquiries that are underway also have potential to address some, but not all, issues raised in this submission.

There is strong justification for further regulation to address issues related to wine retail and a range of advantages to be achieved through inclusion of wine in this Code. As has been demonstrated in this submission, these primarily relate to information asymmetries, transparency for both consumers and producers and the ability of wine producers to compete on a level playing field.

We would be delighted to discuss this submission further if required.

About Us

Australian Grape and Wine Incorporated (Australian Grape & Wine) is Australia's national association of winegrape and wine producers. Grape and wine businesses are unique in agriculture. The sector has traditionally been a leader amongst agricultural industries showcasing the regional and economy wide benefits of promoting locally grown and value-added production. These businesses support employment of over 160,000 people in winegrape growing and production, regional exports and food and wine tourism, making a significant contribution to Australia's rural and regional economies and driving economic growth.

Our role is to help forge a political, social and regulatory environment - in Australia and overseas - that enables profitable and sustainable Australian grape and wine businesses. To do this, our activities focus upon the objective of providing leadership, strategy, advocacy, and practical support. We represent small, medium and large winemakers and winegrape growers, with policy decisions taken by the Australian Grape & Wine Board requiring 80% support, ensuring no single category can dominate the decision-making process and guaranteeing policy is only determined if it provides significant industry benefit. In practice, most decisions are determined by consensus.

Australian Grape & Wine is recognised as a representative organisation for winegrape and wine producers under the Wine Australia Act 2013 and is incorporated under the SA Associations Incorporation Act 1985.

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