SENATE SELECT COMMITTEE ON SUPERMARKET PRICES:

Submission

March 2024

Summary

Australian Grape and Wine Incorporated (Australian Grape & Wine) welcomes the opportunity to share the experiences of the wine sector relating to pricing practices of the major liquor retailers.

There are over two thousand wine producers and approximately six thousand grape growers, a vast majority based in regional Australia. 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. The four largest retailers (Endeavour Group, Coles, Metcash and Aldi) hold a market share of almost seventy per cent, with Endeavour and Coles alone having a fifty-five per cent market share. [1] The high concentration level in the wine retail sector has been partly facilitated by the ease at which liquor retailers can acquire more retail establishments under the *Competition and Consumer Act 2010*. Like many other agricultural industries, this structure often gives rise to producers undertaking commercial negotiations with substantially larger businesses. Any associated challenges impacting wine producers flow directly to growers. Consolidation of liquor retail continues to increase.

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 [2] 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.

The effect of market concentration and the exercise of corporate power on the price of food and groceries

Consolidation of wine retail over the last two decades has changed and continues to change the operating environment for many wine producers. Low pricing and margin erosion are common complaints throughout the supply chain. When combined with practices that introduce uncertainty for wine producers such as de-listing products at short notice or unforeseen requirements for wine producers to contribute to retailer trade spends, businesses become more sensitive to the impacts of margin erosion. The margin squeeze situation is exacerbated by a proliferation of inconsistent market reporting requirements and the imposition of specific production or logistical processes.

To optimise production efficiencies and spread costs, wineries around the world ideally operate at full capacity. This can result in excess production contributing to the contemporary oversupply of low-value commoditised wine. At this end of the market, Australian wines are readily substitutable with those from lower cost trading nations. Unprofitable markets for commercial wines have meant that growers report that they are not recovering production costs. With today's economic climate providing the wine retail oligopoly the ability to buy bulk wine on demand and at distressed prices for their own branded product, winemakers report of an ongoing struggle to protect the brand values they have built over decades and the downward pressure on grape prices continues.

[1] IBISWorld, Industry Report G4123 Liquor Retailing in Australia, IBISWorld, 2023, p. 10.
[2] https://www.accc.gov.au/by-industry/agriculture/wine-grape-market-study-2018-19/final-report

The contribution of home brands to the concentration of market power

In correspondence received late last year, one producer estimated that the channel opportunity for branded suppliers has become fifty percent smaller since the rise of vertically integrated retailers. Retailers can either grow and make wine themselves, purchase wine in bulk and then bottle it under their own brand or enter into private label arrangements with a supplier. With 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. There are concerns that the large retailers use their market power to gain competitive advantage for their own brands. Retailers can do this by manipulating store layout and product placement and various other forms of choice editing. 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.

Supply chain logistics contribute a significant component to the total costs embedded in a typical bottle of wine. Once again, retailers' own branded products have an advantage over competing wine producers for a range of reasons. Retailers have the power to impose logistical parameters and processes that must be abided by, or are difficult to avoid, creating a greater burden on non-proprietary suppliers. Furthermore, unlike other wine producers, a vertically integrated retailer can transfer, or create an internal sale, between their own branded wine and their retail store at a cost exclusive of marketing, distribution and storage. The implication of such an inconsistency would be inconsequential if it were not for the fact that it is permissible that they then calculate wine equalisation tax on that substantially deflated notional wholesale value.

Wine suppliers competing with own branded products for shelf space are also 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.

Australian Grape & Wine continues to field concerns from wine producers relating to the ongoing impacts of vertical integration and in particular, the impact that the proliferation of buyer own branded products has had on their ability to remain competitive in the domestic retail market. In an article published in the Financial Review in June 2023, one major retailer claimed they were continuing to look for opportunities to expand the portfolio, taking advantage of the number of distressed wine assets on the market. [3] Collectively the major retailers own hundreds of their own wine brands. [4] Industry estimates that buyers' own brands could account for as much as thirty five percent of the domestic wine market by volume, compared to about five percent in New Zealand. [5]

Improvements to the regulatory framework to deliver lower prices for food and groceries

The ACCC has acknowledged the high volume of complaints about conduct in the wine industry, however has not to date brought a case for anti-competitive or unfair trading conduct. As with any sector, the ACCC faces some challenges in bringing legal action in this area. This has been partially due to the fact that wine falls outside of the Food and Grocery Code. In 2016, a Senate Inquiry into anti-competitive conduct in the retail wine industry raised

[3] https://www.afr.com/companies/retail/two-years-after-split-from-woolworths-endeavour-eyes-more-wine-buys-20230621-p5dif2
[4] https://www.therealreview.com/who-makes-my-wine/
[5] Pers comms. Wine Australia (2024), based on various market research

many issues in wine retail markets that have not since been resolved. [6] ACCC conveyed the difficulty in obtaining sufficient evidence from witnesses for use in court proceedings due to concerns of the potential for retribution if they were to come forward as witnesses or provide information against their commercial partners. It was thought at the time that Post Harper Review changes to Section 46 of *Competition and Consumer Act 2010* to capture a broader range of conduct and establish a lower evidentiary threshold was an important legislative development towards dealing with these issues. While it remains relatively early days since that amendment was made, there is no evidence of any change as yet. [7]

There is potential that inclusion of wine in a strengthened Food and Grocery Code would assist in addressing imbalances in bargaining power between major supermarkets and their suppliers. This would only prove effective if joining the Code became mandatory for large retailers and potential unintended consequences were identified and dealt with. For example, if additional regulation prompted unchecked vertical integration and/or encouraged buyers to alter their trading practices to avoid transacting in parts of the supply chain that are covered under the Code, it could lead to further increases in buyers' own branded products.

The industry expects to see further improvements in commercial practices in response to the recent strengthening of unfair contract term legislation, along with the unfair trading practices review however until established legal precedence occurs, practices that may (or may not) be unfair are likely to continue. Moreover, these changes do not go so far as to address all of the problems that have prompted this review. The ACCC submission to the Competition Review calls for various measures that we would support including to enhance market transparency, for government-led reforms relating to standardising green claims, and the need for consumers and small business to be well-informed. They also raised the potential for additional policy measures to increase price transparency and quality regulation frameworks in certain circumstances. [8]

Australia's current merger control regime can, and does, affect the competitive conditions. Australian Grape & Wine is aware of and interested in the progress of the Competition Review and the Government's response to the need to strengthen competition laws. The ACCC has recently issued a media release stating that reform of laws governing mergers and acquisitions is urgently needed to bring Australia in line with other developed economies. Their submission to Treasury late last year highlights Australia as an international outlier in not requiring mandatory notification of mergers. It criticises the voluntary nature of the existing notification regime for mergers and the public litigation risk required for raising an objection due the fact that enforcement can only occur through the court system. [9] ACCC Chair Gina Cass-Gottlieb recently affirmed her support for merger reforms to Australia's current merger control regime under the *Competition and Consumer Act 2010* (CCA) in a speech to the National Press Club on 12 April 2023, criticising the fact that the current system is voluntary and enforcement-based and acknowledging the growing problem of concentration in Australia. To date, the transactions relating to wine retail that have caught the attention of the ACCC have related to acquisitions of pubs and bottle shops and the potential for liquor retailer consolidation to impact consumer choice in the location.

Successive acquisitions of smaller independent liquor retailers by larger chains commenced in the late nineties and led to a rapid growth in market share in a short space of time. Consolidation continues and the types of acquisitions have expanded to include hotels, online businesses, as well as winemaking, storage, packaging and bottling facilities. Several purchases of independent retail outlets have been investigated by the ACCC and not opposed. A key focus of the investigations has been on whether there will be an impact on competition between major retailers and other independent retailers in the local area. As these individual acquisitions don't tend to lead to lessening of

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[6] ACCC (2016) at Australian grape and wine industry – Parliament of Australia (aph.gov.au)
[7] https://treasury.gov.au/publication/p2015-cpr-final-report
[8] https://www.accc.gov.au/system/files/CompetitionReview-ACCCsubmission13February2024.pdf
[9] https://www.accc.gov.au/system/files/accc-submission-on-preliminary-views-on-options-for-merger-control-process.pdf

competition on their own, there has been an accumulation of market power over time through a strategy of small serial acquisitions. Similarly, the impact of one acquisition on wine wholesale markets is insufficient to cause concern when assessed in isolation of the others. Thus, we welcome a statement by the ACCC that they intend to make it harder for big companies in concentrated and consumer-facing sectors such as retail and liquor to merge.[10]

Frameworks to protect suppliers when interacting with the major supermarkets

Issues relating to fear of retribution are apparent across the supply chain meaning that businesses refrain from reporting their concerns or speaking out publicly. The problem occurs in parallel to a lack of faith that there will be anything to gain from raising a dispute. Inclusion of wine in the Food and Grocery Code along with a functional dispute resolution mechanism under that code would assist in resolving this issue to some degree.

Other related matters – information asymmetries and production scheduling

Retailers have significant visibility over consumer demand in the domestic market. They can interrogate search data and in-store sales data to act quickly on market signals to identify what inventory they should be holding and to be early movers when an alternative wine style or variety is taking off. Their respective customer loyalty programs provide them data relating to customer demographics and geographics, purchasing patterns and other market insights that allow them to build stronger relationships with the consumer base. This type and extent of data is not available to their supplier competitors. This means that retailers' privately owned brands have a competitive advantage over other wine supplier brands who they compete with for shelf space. Retailers enjoy this advantage in parallel to an oversupplied market allowing them to respond quickly to market signals by purchasing bulk wine for their own branded products.

For non-proprietary brands, there is an expectation of year-round availability of each brand. Supply shortages have been associated with product de-listings. The retailers' own branded products are not subject to this risk. Retailers have data driven insights that enable operational decision-making in real-time, reducing costs associated with over-runs or product shortfalls. However, evidence from wine producers suggests that the demand forecasting they receive from the retailers is often inaccurate. This can leave them with an excess of wine, which is not always suitable for an alternative channel.

Other related matters - transparency

Consumers are unable to easily identify buyer own branded wines as these products often have a look and feel reminiscent of those made by boutique wine businesses. As outlined, buyer own brands have a potentially unfair competitive advantage over other suppliers' brands and continue to grow their significant share of the domestic wine market.

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 that 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. As the current environment lacks transparency, it is not providing for this price premium opportunity to be realised.

Australian Grape & Wine would be interested to engage in further consultations about how this could be resolved.

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[10] Australian Financial Review (2nd February 2024) https://www.afr.com/policy/economy/the-accc-wants-to-block-these-mergers-20240202-p5f1y8

Summary

There is strong justification for further regulation to address issues related to wine retail. As has been demonstrated in this submission, strengthened competition laws or policies would have potential to improve competition through resolving information asymmetries, improving transparency for both consumers and producers, addressing creeping acquisitions, and ensuring that wine producers compete on a level playing field with the major retailers they have little choice but to supply to.

Further information about the wine supply chain and the role of Australian Grape & Wine is provided below. We would be delighted to discuss this submission further if required.

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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. Contraction of the wine export market following the loss of the China market has exacerbated the reliance of wine producers on the domestic market heightening their demand side risk.

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 benefit from 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.[11] 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 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 Winegrape 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, there was a lack of evidence of industry-wide support for further regulation through a

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

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 as has been acknowledged by the ACCC in their follow up report. We estimate that 60-70% of Australian winegrapes processed are done so by Code signatories, and that this percentage is closer to 75% if only wineries above 10 000 tonne capacity are considered.

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. Some degree of pricing ambiguity is broadly accepted, particularly in the ultra-premium and hard to get wine segment. 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 more susceptible to competition issues.

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 and unique from other liquor industries. 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 pricing throughout the supply chain is essential for the ongoing prosperity of all these businesses. 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*.