



13 May 2014

Ms Clare Sibly
Dairy Product Manufacturing Case Study
Productivity Commission
Locked Bag 2, Collins St East
MELBOURNE VIC 8003

Dear Ms Sibly

The Australian Food and Grocery Council (AFGC) welcomes the Productivity Commission's review of the cost of doing business in the dairy product manufacturing industry. The dairy sector is a key part of the Australian agri-food industry and one of the industry's largest export sectors. Given the tight timeframe for initial input, this letter draws on previous AFGC reports (attached) to highlight competitiveness issues facing the food industry broadly.

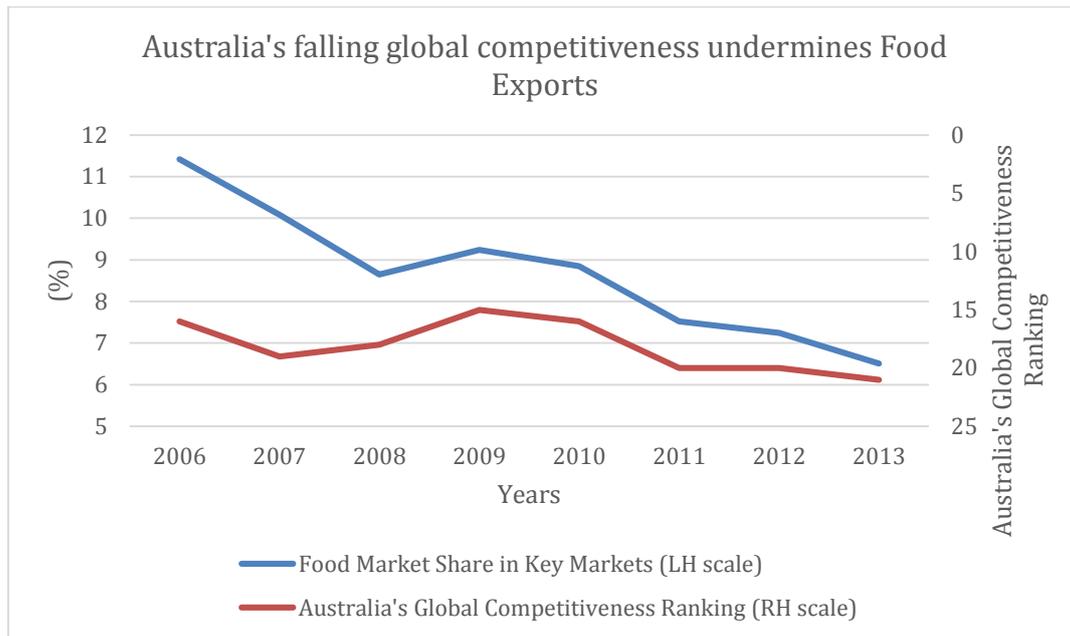
The AFGC is the peak national body representing the food, beverage and grocery manufacturing industry, Australia's largest manufacturing sector. Through the Agribusiness Forum, the AFGC also represents companies involved in the early stage processing of agricultural commodities (otherwise known as semi-processed food). The Australian food, beverage and grocery manufacturing industry has an annual turnover of approximately \$111 billion, directly employs almost 300,000 people, with half of those in rural and regional areas, and generates \$24 billion in exports.

The enormous opportunities for Australian agriculture, agribusiness and food industries presented by increasing food demand in Asia have been highlighted extensively. Increasing global population, rising incomes and greater demand for protein and high value foods presents Australian agri-food industries with a platform for growth to 2050. Dairy has been identified as a sector with particularly bright prospects.

However, the significant global opportunities for the Australian agri-food sector are in stark contrast to the challenges faced. Increases in regulation, inflexible labour arrangements, and poor infrastructure are the primary causes of Australia's fall from the top 20 competitive countries in the world (as measured by the World Economic Forum). In 2006, Australia was ranked the 16th most competitive economy in the world and had an average 11 per cent market share of food exports in key Asian markets. By 2013, Australia had fallen to 21st most competitive country and our market share had fallen to an estimated 6.5 per cent (see chart).

The fall in Australia's international competitiveness affects all industry sectors but can be particularly damaging for export-focussed sectors, including dairy.

Australia's Competitiveness and Food Market Share



Source: World Economic Forum (2013): Global Competitiveness, & calculations from UN Comtrade Database (2014): Food market Share.

The recent AFGC and KPMG report, *Competitiveness and Sustainable Growth*, shows that Australia's food processing industry has focused its efforts on cost reduction, productivity improvements and business re-engineering. Using a combination of financial modelling, interviews and surveys with industry leaders, the report clearly indicates that the food and grocery manufacturing industry is facing continued pressure to remain competitive and grow.

Key findings and trends outlined in the industry-first report include:

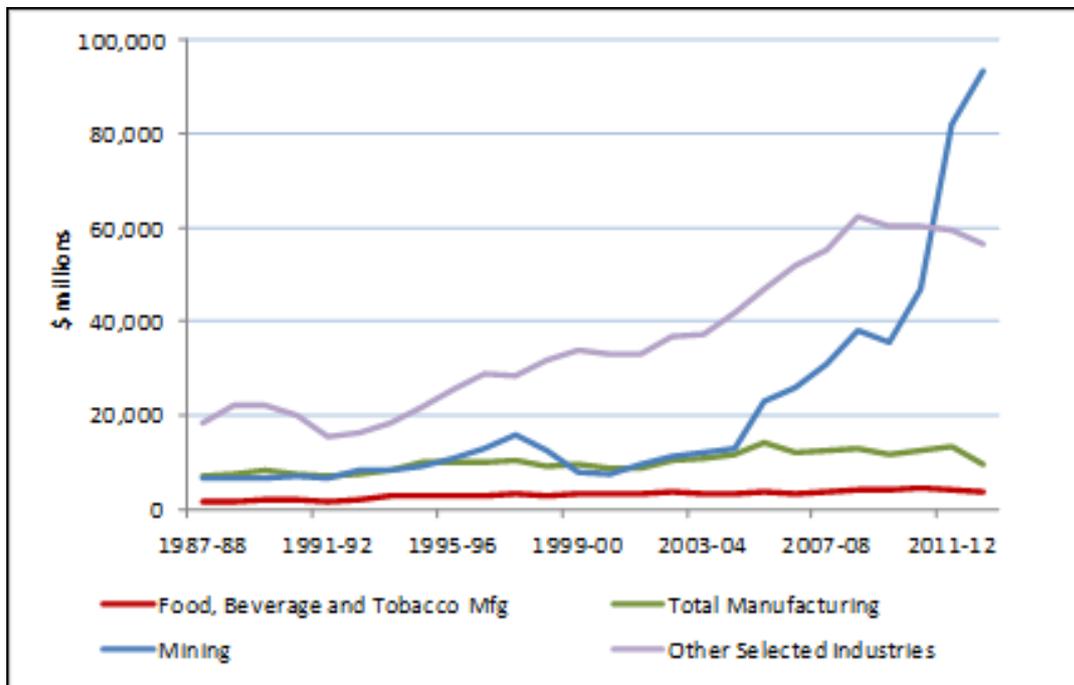
- Growth in the supermarket sector at 4.5% BUT food and grocery manufacturing industry declined by 2.2%
- Food and grocery industry drop in profits 6.9% FY09 to 5.7% FY12
- Food and grocery manufacturing increase trade spend 19.5% to 23.4% with no uplift in sales volumes.
- Food and grocery manufacturing operating costs stable at 23% of gross sales.
- Food and grocery manufacturing capital expenditure growing at 10% per annum.
- Food and grocery manufacturing R&D declined by 4.5% to 3.8%
- Cost of operating in Australia is increasing vs. other mature markets.
- Food and grocery manufacturers' profitability lower than international comparators with EBIT gap widening from 1% FY10 to 3% FY12.

As a result of these factors, the food manufacturing industry is facing continued pressure. Manufacturers are taking measures to contain costs and preserve margins, including capacity rationalisation and exploring new channels to market. However, the combination of rising input costs, reducing prices and an increase in low cost imports has negatively impacted profitability, reducing the attractiveness for further investment in the value added food manufacturing sector in Australia.

Total investment (i.e. fixed plus financial capital) in the food, beverage and tobacco manufacturing sector has been relatively flat over the past 10 years, with the amount spent on investment in 2011-12 at an almost identical level as that spent in 2002-3. While there has been recent growth in capital investment in food

processing, it is only a regaining of ground lost during the financial crisis and is generally focussed on the replacement of assets rather than investments that are aimed at growth.

Total Investment in Industry Sectors



Source: Australian Bureau of Statistics, *Private New Capital Expenditure and Expected Expenditure, Australia, Dec 2013*, Catalogue no. 5625, March 2014; and estimates.

Note: the ABS defines Other Selected Industries as all other industries except finance and insurance services.

To stimulate growth in the agri-food processing sector, at a time when economic and retail market conditions risk losing opportunities, requires policies that improve Australia's cost competitiveness and encourage a significant step change in investment in agri-food processing sectors.

The Productivity Commission's review of the cost of doing business in the dairy product manufacturing industry is a welcome opportunity to identify the costs facing the industry, and to contrast those with our international competitors. The Australian Food and Grocery Council would welcome an opportunity to discuss this further as the Commission's final report develops.

Yours sincerely

Michael Rogers
Manager, Agribusiness Forum
Australian Food and Grocery Council