GRAIN PRODUCERS SA
The voice of South Australian growers

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Submission by Grain Producers SA ("GPSA") to the Essential Services Commission SA ("the Commission") Draft Report released for public consultation, in relation to its Inquiry into the South Australian bulk grain export supply chain costs (August 2018).

Introduction

Grain Producers SA (GPSA) is the peak industry body for South Australian grain growers. GPSA is non-political and represents producers to government, the community and industry, including grain marketers, exporters, storage and handlers, researchers and farm input suppliers. We develop and implement policies and projects that promote the economic and environmental sustainability of South Australian grain growing businesses.

GPSA welcomes the request by the Essential Services Commission of SA (the Commission) for evidence-based submissions on the extent to which stakeholders agree or disagree with the draft findings.

The attached submission reflects on the draft report, considering member feedback gained from information sessions held in regional South Australia, as well as our previous deliberations on the structure and settings of South Australian bulk grain supply chain costs.

Date: 3 October 2018

Draft Finding 3.1

Australian grain benefits from being high quality, sustainable and clean. Production is counter-cyclical to the northern hemisphere, so Australian grain has a brief window of opportunity to maximise returns.

Noted - no further comment

Draft Finding 3.2

South Australia is a small player in the global grain market. It must continue to pursue efficiency in supply chain costs to enable the industry to maintain its global competitiveness.

The grain industry is however a significant industry for South Australia, generating about $2 billion per year for the State's economy as well as employing thousands of people in food-related industries. Consider the benefit for rural and regional South Australian grain producers should $7 million ($1/tonne) in supply chain efficiency be captured.

Draft Finding 3.3

Responding to the variability of harvests is an important aspect of the supply chain. Participants need to be able to manage costs in poor harvest years, while still having the capacity and capability to manage large harvests. Given the variability in grain production, high returns in good years may be necessary to offset poor returns from bad harvest years for participants to achieve a reasonable return on average.

The investment in capacity and capability needs to be planned accordingly, by providing enough capacity to cope with peak demand and avoid lengthening harvest for grain producers or of queues of ships awaiting berths, while ensuring that the capability provided will be well-utilised and idle capacity reduced to a minimum.

For the a vertically integrated near monopoly, does the evidence support: 'high returns in good years may be necessary to offset poor returns from bad harvest years'? This may be true for an individual grain producer, but does that reflect necessarily the impact on a 'reasonable return on average' for the grain supply chain to a market? Consider Figure 3.2 State grain production, by volume 2008-09 to 2017-18 (p.16) with Figure 4.5 Movements in Viterra's revenue, operating expenditure and operating surplus, 2007–2017 (p.56). In Season 2014-15 a harvest of 7.6 million tonne shows an operating surplus of roughly $100/tonne compared with Season 2016-17 a harvest of 11.1 million tonne shows an operating surplus of roughly $97/tonne.

Draft Finding 3.4

The grain trading market in South Australia appears to be competitive, with 11 grain traders

Presumably the number of grain buyers willing and able to buy grain affects the overall demand for that grain. With more buying, there is increasing demand. The relationship is relatively well-known. Conversely with fewer buying, there would be lessening demand. If a trader's grain buying activity is differentiated by grade - segregation, then does the number of grain traders mean higher prices across all grades - segregations?

The draft report notes; 'that for the 2016-17 harvest it (Viterra) provided 57 segregations' (p.103). A grain trader values the segregations by commodity and grade to meet its customers' requirements. Does the grain trader need to buy all 57 segregations to fulfil shipping slots? Assume one or few port terminals are desirable to minimise charges per ship visit to load the grain (i.e. a cost-efficient supply chain). Does the number of grain traders mean demand and higher prices across all segregations are achieved at all port terminals and all upcountry sites that feed into those port terminals?

Apparently, no grain traders have taken the opportunity to contribute and make a submission to the Commission's inquiry into the South Australian bulk grain export supply chain costs. Yet commodity trade and grain production are central to the prosperity of South Australian grain producers.

To measure and balance the impact of dominant grain traders locally the following metrics might be considered:

1. Track the APW wheat prices at Kwinana compared with Port Adelaide over time (i.e. Deduct the appropriate sea freight differential)
   - Grain only loading facilities
   - Capital cities
   - Export oriented States (i.e. an appropriate comparison)
   - Similar grain quality
   - Independent data i.e. Profarmer 'best bids'

2. The number of grain traders and their relative volume on the shipping stems in South Australia compared with other states – but most particularly Western Australia

3. Track the spread between Port Adelaide compared with Port Lincoln in 2017 for APW wheat pricing – a suggestion from grain producers personal experience at the Commission's consultation sessions.

Draft Finding 3.5

Viterra has a high market share of bulk grain storage in South Australia, operating 94 percent of commercial grain storage sites in South Australia. Total on-farm storage capacity appears to have been static over the 10 year period considered, and it is relatively small in South Australia.

Consider ‘South Australia and Western Australia are export focused markets, each exporting around 85 percent of their grain production’ (p.16); ‘total on-farm storage capacity has not significantly (in South Australia) changed since 2010, according to ABS and PIRSA’ (p.22). ‘From one estimate, 80–90 percent of delivered grain is initially received as grower warehoused stock, with around 50 percent sold within 30 days and 90 percent sold within three months ‘(p.21).

Apparently most South Australian grain producers accept a short marketing window and sell grain at a time when prices may be profitable or may not. If the grain producer could carry the grain over a longer time frame, ‘purely by weight of probability due to the cyclical nature of grain prices’ (GRDC, Grain Marketing, 07 September 2018), there are more opportunities to sell at or above long-term prices.

For example, if a drought season in eastern Australia ensued after the South Australian harvest, carryover from the previous year will find its way from South Australia that could and would be shipped to ports such as Newcastle and Brisbane relatively easily. A lack of on-farm storage to retain grain removes from South Australian grain producers’ opportunity to participate or benefit from carryover grain and the selling of commodities that are in high demand and short supply domestically.

At the Commission’s consultation sessions were grain producers who drew from personal experience about post-harvest delivery policies, such as rejecting grain stored on farms for extended periods. There may be valid reasons not to accept the grain, it may not be fit for export, but these grain producers believe they have no choice other than to sell grain at harvest or soon after when prices may be profitable or may not.

Draft Finding 3.6

Genesee and Wyoming Australia (GWA) is the primary provider of freight rail services for bulk grain in South Australia, although the relatively short distances to port means road transport successfully competes with rail.

At the Commission’s consultation sessions were grain producers who from personal experience could not quantify off-farm supply chain costs or how these costs relate to the prices offered at export pathway receival sites. The grain producer confined to an export pathway relies on general evidence based on the individual situation. To enable the grain producer to consider the benefits by comparison, these costs must be identified and quantified in a meaningful way.

When a grain producer sells grain into an export pathway a freight component is attributed to the trade. The capability to do this currently exists with the standard mode of transaction using the Grain Trade Australia (GTA) No 2 Contract - Track Contract. Freight components or Location Differentials (LDs) are designed solely to price grain at upcountry sites for the contract. In South Australia LDs are based on the Viterra Export Select values: ‘Export Select is optional for Viterra’s customers, but it is the preferred method for export traders’; and ‘potential Export Select benefits to traders include:

protection from adverse freight rate movements, because rates are fixed at the time of transfer' (p.47). Unless a grain producer can deliver by road transport at a freight cost lower than the LD between the farm gate and port terminal it is better to transfer freight cost risk to the grain trader and/or Viterra at an upcountry site.

A major impact for grain producers desiring to make their off-farm supply chain efficient and deliver into Port Adelaide, Port Lincoln or Wallaroo is that these port terminals are zoned to exclude grain delivery. A constant frustration from personal experience at the Commission's consultation sessions has been the allocation by farm of a 'local delivery zone for each port' and by grain as; 'in line with the available segregations.' (Viterra Harvest Information 2017/18, p.16).

There is no discernible difference in transport mode between the up-county delivery point and the port terminal other than the timing and discretion of the grain trader in choosing to move the grain at a freight cost lower than LD. This example is at no freight cost risk because the Viterra export select value or LD charge has been passed back to the grain producer at the point of sale.

Draft Finding 3.7

Viterra has a high market share of supply chain port bulk grain loading services, with 91 percent of market share throughput in 2016-17

Rural and regional grain production and associated activities are fundamental to South Australia's economic prosperity. Export grain is a central pillar in local economy and must be connected to markets here and overseas as we depend on globally controlled supply chains for market access. A high market share of supply chain port bulk grain loading services should not be an impediment to grain producers receiving parallel prices for their grain or reduction in their supply chain costs.

Evidently, no competitor or potential competitor has taken the opportunity to contribute and make a submission to the Commission's inquiry into the South Australian bulk grain export supply chain costs.

Draft Finding 4.1

Supply chain freight and port services fees are being set on a competitive basis, as a result of the relevant markets being either competitive or subject to sufficient regulatory oversight. A possible exception are the fees for port receival and outturn from storage services. In addition, Viterra's upcountry storage and handling facilities are not covered by any industry-specific regulation. Consequently, it is important that the performance and behaviour of Viterra be assessed by the Commission, given its position of strength within the supply chain (upcountry storage and handling services, and port handling and loading services.

New entrants must derive a tangible benefit from accessing bulk handling services both at port and along the related supply chain. Consider the Australian Competition and Consumer Commission Bulk wheat ports monitoring report 2016–17 that notes; 'While new entrants have commenced export operations, their entry has been dependent on their ability to access specific infrastructure across the supply chain and not just at port. For some new entrants, their export programs are opportunistic and intermittent and rely, for example, on the use of mobile ship loaders, good weather and cooperation of and access to public access berths' (p.13). Consider comments made to Draft Finding 5.5.

Draft Finding 4.2

While Viterra faces some competition (actual and potential), the extent to which competition places effective and credible discipline on Viterra's behaviour is not clear. The global market may place more effective discipline on Viterra's behaviour than any local competition could.

At the Commission's consultation sessions were those whose personal experience meant they were now regretful of the laws that deregulated the bulk wheat export market and the South Australian Cooperative Bulk Handling (SACBH) corporate structure demutualisation that formed AusBulk and United Grower Holdings.

It is agreed that the breakdown of regulations and awareness in grain producing rural and regional communities is in separating dependency on mutual benefit to a context in which big commodity traders have thrived.

Draft Finding 4.3

Viterra seeks to measure its performance in meeting the customer service needs of growers, and it does so in a robust manner. It submitted evidence of its actions to improve customer service in response to customer feedback. These actions are consistent with a firm seeking to meet customer needs.

In South Australia the opportunity to add any additional grain producing customers is low and the fixed costs of the overall supply chain system is in place. Once the storage and handling sites are established, the marginal cost of providing additional services to another site is low. It would be costly and duplicative for prospective storage, handling and port terminal service providers to enter the market and invest in an additional set of facilities and systems. Because of economies of scale, one operator could serve the entire supply chain more efficiently than several smaller storages; handling and port terminal service providers that would need to make duplicate physical capital investments. In ensuring economies of scale, relative to the quantity demanded in the provision of storage, handling and port terminal services, grain accumulation is a key benchmark. One way to retain grain for maximum accumulation and site turn is to ensure that an appropriate amount of customer service is provided to satisfy the needs of grain producing customers.

Draft Finding 4.4

Viterra appears to be operating as a cost effective bulk grain accumulator that can meet peak harvest demand and compete in the global context

The draft report evidences Viterra has reducing its operating expenditure based on Figure 4.1 Movement in operating expense, Viterra, 2007–2017 (p.44); the indexed real $ per tonne has reduced from about $100 per tonne to less than $50 per tonne.

Draft Finding 4.5

Based on a sample of fees and grain paths, total upcountry-to-vessel loading fees have been broadly stable in recent years, having moved at an average rate only slightly above inflation from 2013-14 to 2017-18. The Commission found no evidence that Viterra's fees are excessive compared with the total fees charged by its eastern Australian counterparts as shown by AEGIC's latest study of Australian supply chain costs.

The draft report evidences 'Movement in operating expense, Viterra, 2007–2017' (p.46) that at the Commission's consultation sessions attendees whose personal experience drew a comparison with the Grain Producers SA May 2017 submission to the Commission; 'Inquiry into the South Australian bulk grain supply chain costs'; Chart 1 calculating a storage and handling cost to FOB (p.5). Some session attendees suggested the evidence shows that the benefit of economies of scale and reducing movement in average operating costs does not appear to have flowed through as supply chain cost efficiencies for the ultimate payers of the bulk grain export supply chain.

AEGIC's study of Australian supply chain costs report has yet to be published publicly and no contribution to the discussion can be made.

Draft Finding 4.6

Based on the available evidence, Viterra is earning returns towards the upper level of what may be considered reasonable. The Commission's analysis of returns is consistent with the fee analysis, which showed Viterra to date has apparently not chosen to share efficiencies with industry through lower fees. However, the Commission did not conclude that Viterra's returns are currently unreasonable.

Future concerns may arise if the trend in Viterra's operating surpluses continues to the point at which returns exceed a reasonable level. This point may occur if Viterra continues to find efficiencies to reduce costs, without sharing the benefits with industry through lower fees.

The Commission engaged financial consultants Value Adviser Associates Pty Ltd (VAA) to advise on the rate of return that an investor would require to invest in a firm in a similar market and with similar characteristics to Viterra (p.55).

In its report; ‘Study of financial returns benchmarks - Inquiry into the South Australian bulk grain export supply chain costs’ VAA noted that: ‘It is not intended that the VAA’s assessment of reasonable returns for a business with similar characteristics to Viterra should be considered to be a recommendation for regulatory intervention. Similarly, it does not necessarily represent the findings that would be reached if a regulatory weighted average cost of capital study was undertaken, as different methodologies would be applied along with access to more detailed and confidential information’ (p.5).

If a weighted average cost of capital study were undertaken using the business’ actual financial statements on the cost of capital and represent the future returns for an efficiently managed vertically integrated business; would the earning returns reflect differently?

Draft Finding 4.7

In relation to pricing behaviour, the Commission found possible evidence of a pricing structure that potentially serves as a barrier to new competition or expansion by existing competitors (specifically, the Receival at Port Service Fee (from Approved Third Party Storage)). For many practices that may raise market power concerns, however, there are operational justifications. There is also a need to consider their cumulative impact. Given the draft finding that Viterra is currently earning reasonable financial returns, this fee, in isolation, does not provide conclusive evidence that Viterra is exercising market power.

Given the available evidence, the Commission considers Viterra’s behaviour in relation to the remaining fees and practices investigated (Export Select, grower direct deliveries to port, capacity booking fee, lost capacity fee, shrinkage and dust rates, and the impact of vertical integration) is not, on its own, detrimental to the efficiency of the supply chain.

Does the Receival at Port Service Fee (from Approved Third Party Storage) deter any stakeholder wanting access at a port? Do stakeholders have evidence that counters the Commission’s draft findings on the Viterra fees and practices investigated?

The contractual arrangements between players in the supply chain seeking to export from Viterra’s inner or outer harbour Port Adelaide terminals are private to those players. Three players in four distinct nearby locations conducting ship loading activities appear to be in contrast with how to represent an integrated and efficient supply chain.

This may or may not necessarily be a problem, but it is possible unnecessary infrastructure duplication is occurring because interface operations cannot be negotiated by those players. There may be a transfer of inefficiency costs between the players, and ultimately to the export grain producer.

A lack of meaningful information hampers further contribution concerning operation of a Third-Party Storage Facility approved by Viterra**.**

Draft Finding 4.8

The Commission found evidence that the market is not sufficiently informed, in the case of both growers and traders, and potential competitors. If this lack of information is an issue, to what extent does it have a material impact on the efficiency of the supply chain? What is the evidence?

A potential improvement to the transparency and ability to negotiate supply chain fees would go some way to redress the imbalance between market participants and grain producers. Consider Draft Finding 3.5; ten years down the track, there is evidence to show that insignificant steps have been taken to improve total on-farm storage capacity.

Draft Finding 5.1

Grain pooling is one of many tools available to growers to manage risk. To the extent that individual growers cannot manage an issue, the grain industry should be able to manage such issues.

No further comment

Draft Finding 5.2

The public release of more grain stock information has both strong industry advocates and opponents. To the extent that the release of more stock information has net benefits, the grain industry should be able, by itself, to achieve the best outcome.

If this is an issue, what additional stock information should be released? To what extent would it have a material impact on the efficiency of the supply chain? What is the evidence?

A recent media report 'Drought-stricken farmers in New South Wales are calling on the Australian government to import grain from overseas' (SBS News, 13 August 2018) brings again the question of how much grain is held in storages in Australia? Self-regulation has been advocated and the Wheat Industry Advisory Taskforce recommended an open, transparent grain stocks reporting system in Australia.

Draft Finding 5.3

The freight cost component of the supply chain costs is efficient, within the current economy-wide framework for establishing road user charges and identifying road investment priorities. The competitive road freight industry underpins efficient road and rail freight rates. This competition is complemented by regulatory oversight through the rail access regime

Grain Producers SA supports greater and less restrictive access to the South Australian road network for heavy vehicles. 'First mile' freight in rural and regional areas is constrained by vehicle dimensional limits.

Draft Finding 5.4

It is not clear that the practice of quality arbitrage is detrimental to the overall returns achieved by the grain industry. It does not seem to be an issue for growers, so long as they receive a price commensurate with the value of the grain on the global competitive market.

At the Commission's consultation sessions grain producers described from personal experience that grain they delivered they sold at a quality level above the grade - segregation offered and the arbitrage benefit dematerialised. They described delivery was at a disadvantageous price because the grade - segregation was not available locally or required transport from farm to a distant location. It is issue for these grain producers as they receive a price less than the value of the grain. The arbitrage benefit is held by the storage and handling facilities and blending opportunity between the storage and handling facilities and the grain trader.

Draft Finding 5.5

The Commission will consider further the merits of the GPSA proposal for a statewide transport access regime (including grain storage and handling) in the light of submissions to this inquiry Draft Report. It will also consider any position reached by the DAWR in its PTAC review final report.

Consider remarks by the Australian Competition and Consumer Commission (ACCC) concerning regulatory access arrangements to vertically integrated upcountry storage networks contained in its December 2017 submission in response to the Department of Agriculture and Water Resources' issues paper on the review of the Competition and Consumer (Industry Code – Port Terminal Access (Bulk Wheat)) Regulation 2014 and May 2018 submission in response to the interim report:

- The Code would be considerably more effective if it were extended to apply baseline regulatory access arrangements to vertically integrated up country storage and handling networks.

ENDS.