



Inquiry into the South Australian bulk grain export supply chain costs – Part 1

Purpose of the Inquiry:

To determine the reasonableness of the costs underpinning the South Australian bulk grain export supply chain

Purpose of this consultation on the Draft Report:

To test the Commission's preliminary findings and to seek further evidence to inform the final advice to Government

August 2018

What we will cover in this presentation



In this presentation we will:

- ▶ set the scene for the Inquiry
- ▶ assess the efficiency of the supply chain and how we have gone about making this assessment
 - it has not sought to assess perceptions of fairness (equity)
- ▶ explain why Viterra has been the focus for the Inquiry
- ▶ present the key findings in relation to Viterra's behaviour
- ▶ outline our draft findings on other issues raised relevant to the Inquiry
- ▶ set out next steps for the Inquiry

Setting the scene for the Inquiry

Part 1: Inquire into the South Australian bulk grain export supply chain (farm gate to export vessel) costs including vessel loading charges over the past 10 years (**supply chain**), having regard to:

- ▶ components of the supply chain costs and their efficiency
- ▶ harvest trends over the past 10 years
- ▶ the basis for recovery of road and rail costs

Part 2: If the Commission identifies areas where supply chain costs are inefficient, options are to be provided for addressing those inefficiencies in the Final Report

State's key objectives



As set out in the Terms of Reference, the Inquiry was established to inform the pursuit of key State objectives for supply chain costs, being to:

- ▶ provide transparency in regards to supply chain costs in South Australia
- ▶ determine areas where future efficiencies may be achieved in the supply chain
- ▶ review the appropriateness of mechanisms used for funding road and rail components of the supply chain costs

Key points about the inquiry



Encouraging you to engage with us

The Draft Report findings are based on the evidence available to the Commission to date:

- ▶ new evidence might influence the findings
- ▶ this consultation provides the opportunity to test, challenge and verify the evidence which has been presented and the analysis to date

The Inquiry's findings (Final Report) will not constitute a regulatory determination nor a binding decision:

- ▶ they will inform broader public and policy debates on the cost efficiency of the bulk grain export supply chain

Key points about the inquiry (contd)



The basis for our assessment

The Inquiry is about efficiency not perceptions of fairness (equity)

Efficiency:

- ▶ economic inefficiency only occurs if a supply chain operator **sustains** a return demonstrably above what would be considered reasonable in a competitive market
- ▶ efficiency has been assessed at the whole of supply chain and market segment level, not at the individual fee level

Equity:

- ▶ covers whether growers perceive they are receiving a fair share of any supply chain efficiencies achieved
- ▶ outcomes can be perceived as inequitable while not being demonstrably inefficient
- ▶ nevertheless, this Inquiry's findings might inform further debate on equity

The bulk grain export industry



Establishing the context for the Inquiry

The context for the Inquiry, according to:

- ▶ global context
- ▶ harvest variability
- ▶ market segments

South Australia is a small player in the global bulk grains market, with a 2 percent market share of exports

- ▶ South Australian bulk grain is more reliant on exports than eastern state producers

We currently have some factors in our favour:

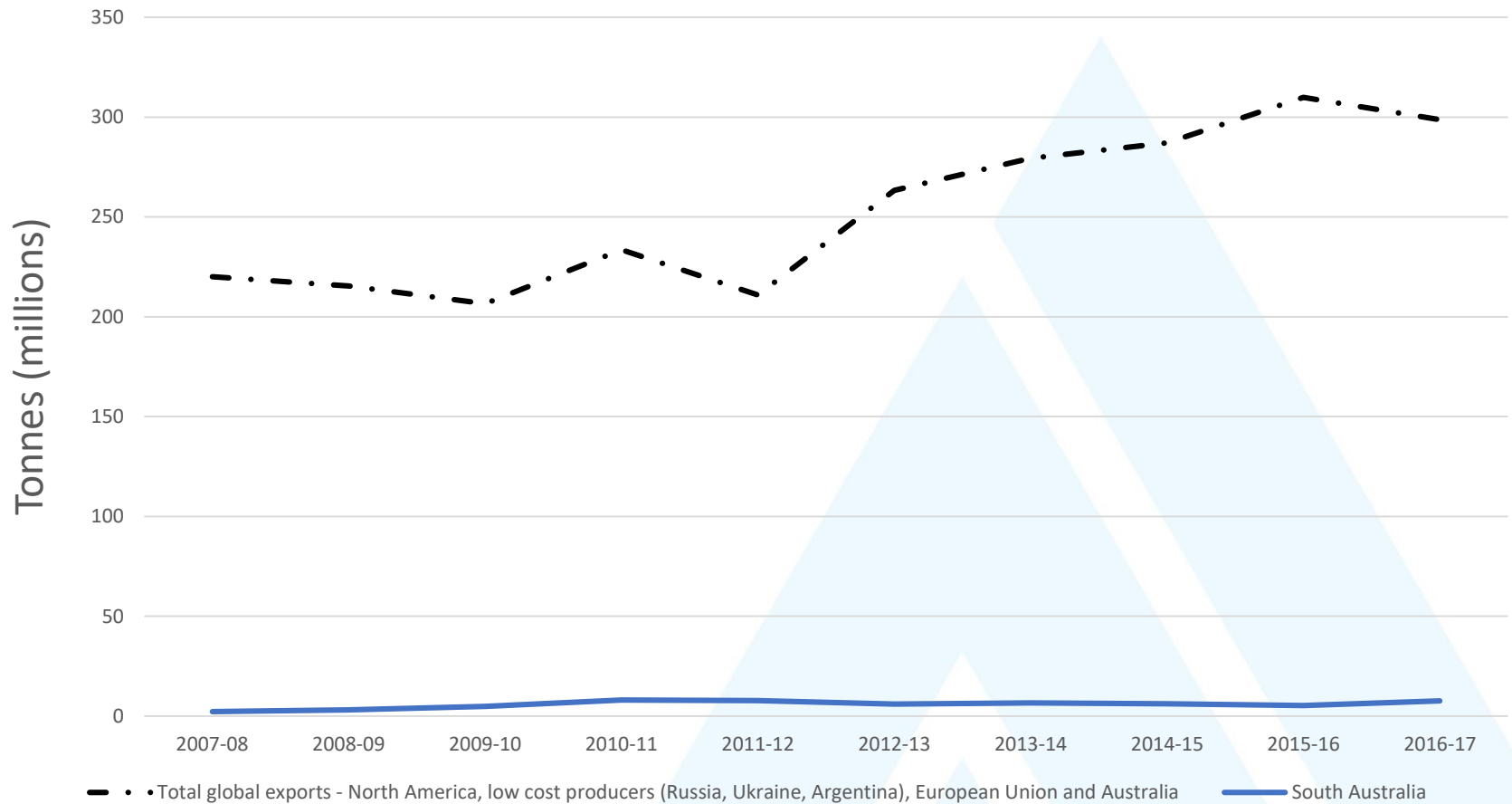
- ▶ harvesting counter-cyclical to most global suppliers and supplying a quality product

BUT

Continuing access to an effective accumulation and delivery system to port and onto ship is crucial:

- ▶ operators must be encouraged to maintain and provide effective services
- ▶ the supply chain must be efficient to encourage sufficient interest from global traders, that usually have many other global supply options

South Australian exports compared with the global market



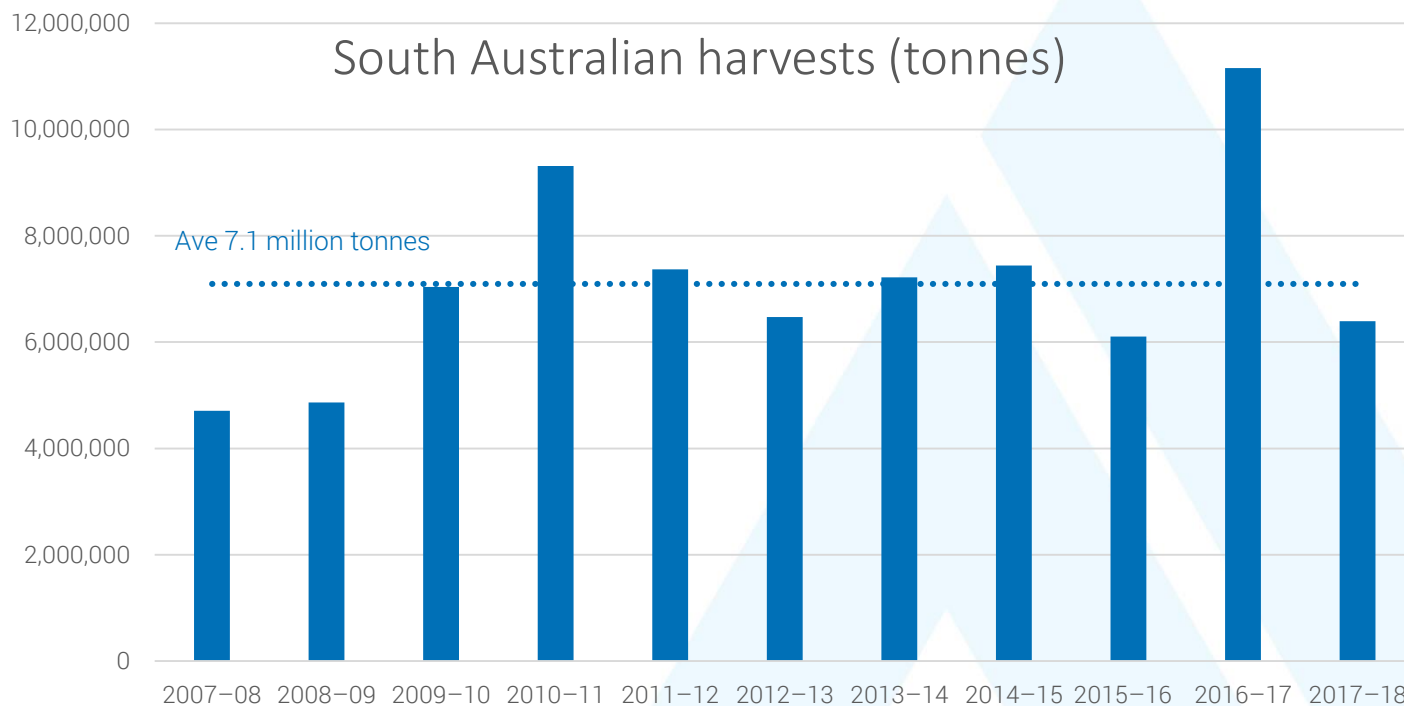
Source: US Department of Agriculture

Harvest variability



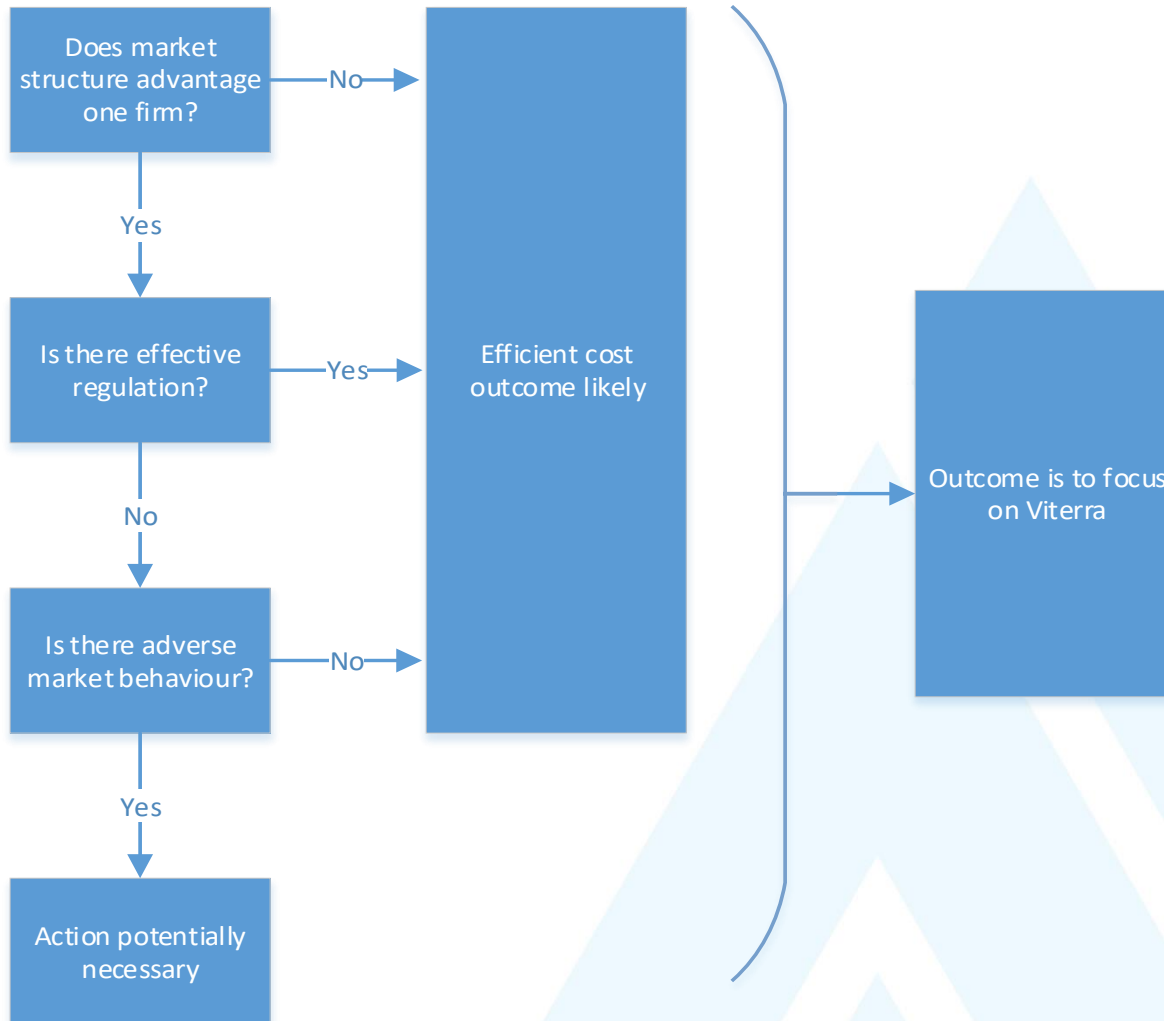
High variability of annual harvests

- ▶ supply chain must have the assets to meet peak harvests

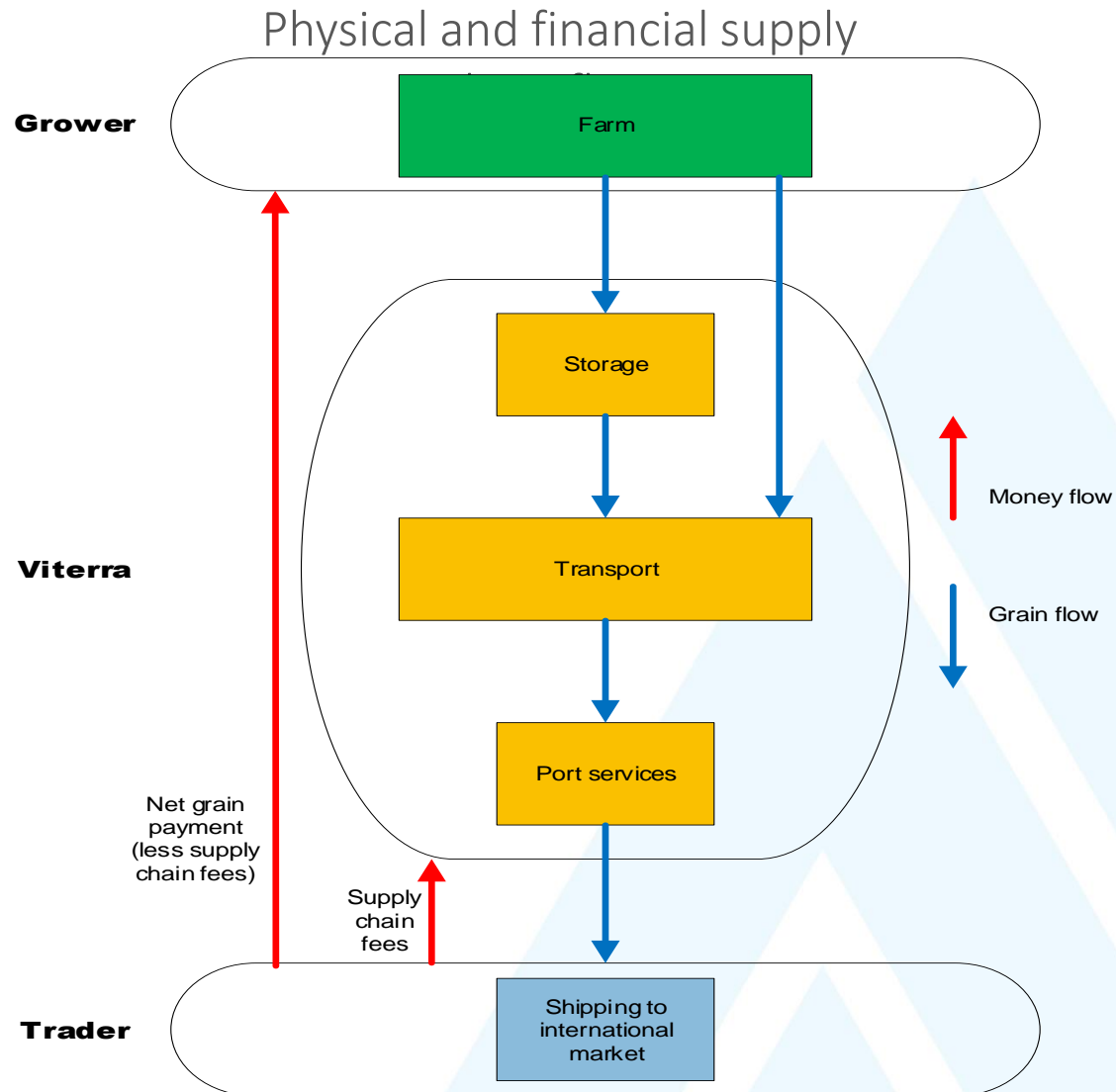


Source: PIRSA

Our assessment approach to the South Australian supply chain market segments



Market segments



Market segments (Contd)



From the previous slide:

- ▶ Viterra has a position of strength within the supply chain
- ▶ it is traders that generally have the direct financial transactional relationship with Viterra, not growers
- ▶ the industry has undergone much change since the days of the single desk
 - with growers arguably having much less direct input into how the supply chain operates
 - but still ultimately accountable to pay the supply chain costs

Why focus on Viterra?



Why we focus on Viterra's performance

Bulk grain handling and storage:

- ▶ Viterra has large share of the market
- ▶ there is no economic regulation

All other major South Australian supply chain service providers (for example, road and rail) are found to be either competitive or subject to effective regulatory oversight for the supply chain services provided

Our DRAFT assessment of Viterra's behaviour

On the available evidence, Viterra:

- ▶ operates as a cost effective accumulator of bulk grain that meets peak harvest demand
- ▶ its behaviour is not inconsistent with a firm seeking to meet customer needs
- ▶ global pressures may influence its behaviour more than domestic issues
- ▶ not exercising market power on a sustained basis

In general, Viterra's fees are not considered excessive when considered against eastern state counterparts:

- ▶ fees tracking slightly above inflation since 2013-14 (based on a sample of fees reviewed)
- ▶ 'Receival at Port Service Fee (from Approved Third Party Storage)' might serve as a barrier to new competition

How do Viterra's fees compare to CBH's?



No evidence of Viterra overcharging once account is taken of the following reasons for CBH fees being lower than Viterra and the eastern states

▶ **Business structure:**

- CBH can concentrate on maximising value to its **cooperative** members, whereas Viterra needs to earn an adequate return for its shareholders
- CBH does not pay tax on profits

▶ **Operational:**

- CBH **potentially** holds some advantages in scale (for example, more throughput with fewer ports)

Viterra's surplus on the rise



Viterra does not release public financial accounts

The Draft Report contains some financial information, presented on an indexed basis to avoid disclosing, at this time, information over which confidentiality has been claimed by Viterra

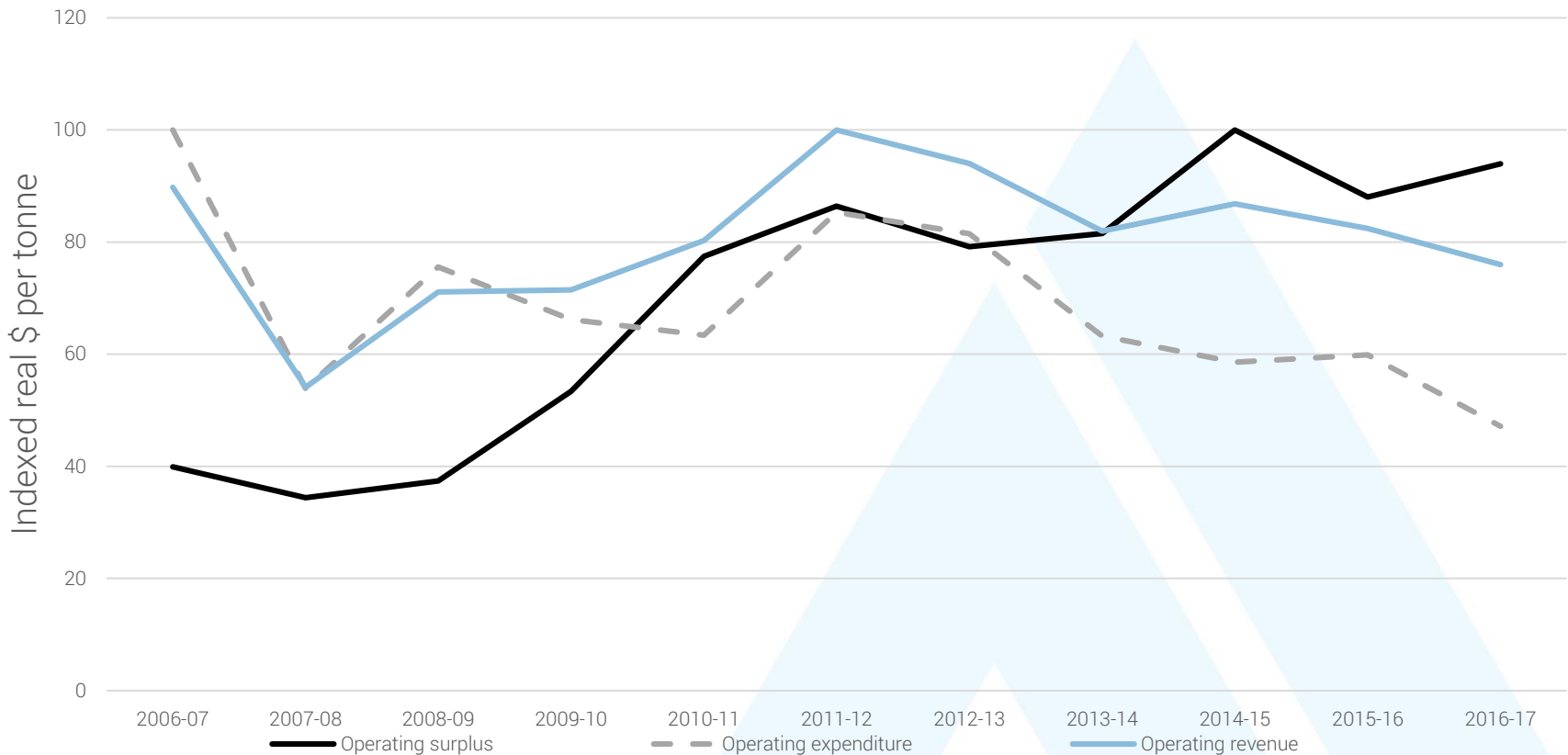
This information shows a trend of:

- ▶ reducing operating costs
- ▶ relatively flat operating revenue from 2013-14
- ▶ increasing operating surpluses

Viterra's surplus on the rise... but (Contd)



Movements in Viterra's revenue, operating expense, and operating surplus (indexed \$real per tonne), 2007-2017



Source: Essential Services Commission analysis of Viterra data

... but returns are not unreasonable



Key draft findings on Viterra's returns are:

- ▶ variable harvests means strong returns in high harvest years may be required to offset weaker returns in low harvest years
- ▶ we have assessed that Viterra's returns are towards the upper level of what might be considered reasonable
 - with our consultant (Value Adviser Associates Pty Ltd) providing advice 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

To date, the evidence available suggests that Viterra has focussed on extracting supply chain efficiencies, rather than on the protection and preservation of unduly high returns

Our assessment of other issues

Issue	Finding
Grain pooling	Can be managed by industry
The release of stock information	Can be managed by industry
Freight costs	Efficient within current economic framework
Quality arbitrage	Not clear it is detrimental to the overall grains industry; does not appear to be an issue for growers providing they receive a price commensurate for their quality
Statewide transport access regime	Will review in light of submissions

What are our draft findings?



- ▶ Bulk grain export supply chain costs are not demonstrably inefficient
 - from an overall and individual supply chain segment perspective
 - but there is some room for improvement, for example greater public transparency around fee levels and Viterra's financial performance
- ▶ Factors influencing this finding:
 - efficient large scale accumulation is likely necessary simply to maintain South Australia's export market share in the global market
 - much of the supply chain is subject to competition and/or regulatory oversight, the exception being aspects of Viterra's services
 - the evidence available to date does not suggest Viterra is exercising market power on a sustained basis or persistently earning excessive returns

These findings do not reflect how the market might evolve

What are the next steps?

- ▶ we are keen to meet with as many of you as possible during this consultation period
- ▶ submissions close Monday, 17 September 2018
 - we are looking for **evidence-based** submissions
- ▶ based on the current terms of reference, we need to provide the Treasurer with a final report by 31 October

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In conclusion



- ▶ A copy of the Draft Report can be found on Commission's website:
www.escosa.sa.gov.au
- ▶ Submissions welcomed by 17 September 2018