Coles Supermarket and the Australian Grocery Industry

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Abstract. The market structure of the supermarket and grocery industry in Australia is oligopolistic. Coles and Woolworths, two local Australian companies, account for more than 60% of the market share. A market with a perfectly competitive structure has a freer competitive environment than an oligopolistic market, which can enhance the interests of consumers. In addition, the Australian supermarket and grocery industry market is highly regulated by regulators such as the Australia Competition and Consumer Commission (ACCC). Nevertheless, oligopolistic companies rely on their position in the industry to engage in illegal activities. In addition, it is challenging to accurately predict consumer preferences, as many factors affect consumption choices. Furthermore, the goods sold by Coles are daily necessities, and the price elasticity of such goods is low. This analysis combines Coles supermarket with the home appliance market as the changes in consumer demand for home appliances at Coles may have a spillover effect on the home appliance market. Coles has economies of scale and scope, which helps it to reduce marginal costs and become more competitive in the industry. In addition, Coles has changed its traditional advertising methods and now uses the Internet to attract younger consumers.

Keywords: consumer preferences; perfectly competitive structure; complementary products

1 Introduction

Supermarkets are the primary source of food supplies for households in high-income countries (Jenneson et al., 2022)[11]. The development of the supermarket industry is closely related to the daily lives of consumers and is influenced by social development. Even at the height of the Covid-19 pandemic, people still needed to go to supermarkets, and door-to-door delivery services provided by supermarkets offered consumers safety and convenience. As a result, the supermarket industry has become one of the few profitable industries during the recession. As one of Australia's largest supermarket and retail chains, Coles has a significant presence in the Australian supermarket and grocery industry and is one of the most iconic Australian supermarket and retail industry companies. Therefore, this report will conduct a multi-faceted analysis of the Australian supermarket retail and grocery industry using Coles as a case study.

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2 Analysis

2.1 Market Analysis

Market Structure.

The supermarket and grocery industry is one of the most competitive industries in Australia (IBISWorld, 2022)[9] and has long been an oligopolistic market. As shown in Figure 1, four companies currently dominate the Australian supermarket and grocery industry. Woolworths has the largest market share at 37.1%, followed by Coles Group at 27.9%. The two companies together account for more than 50% of the entire market. Aldi and Metcash have smaller shares of the Australian market at 9.5% and 6.9%, respectively, while other supermarkets and grocery companies account for only 18.6% of the market. This reflects the oligopolistic structure of the Australian supermarket and grocery industry. Coles and Woolworths account for a high proportion of the total industry output and control industry products. Furthermore, the Australian government gives space and freedom to the market development of these companies (Patmore et al., 2021)[12]. Therefore, the formation of an oligopolistic structure in the Australian supermarket and grocery industry is due to the monopoly of market competition, as well as the following factors.

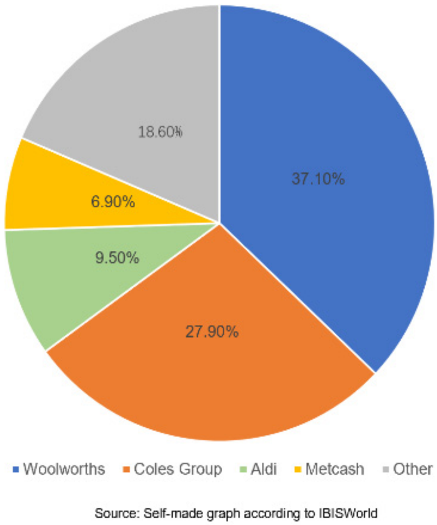


Fig. 1. Major Supermarkets and Grocery Stores In Australia

Geographic Location. Australia does not have any land borders. Therefore, international cargo transportation mainly relies on sea or air transportation, which is costly and takes a long time. Products such as vegetables, fruits, dairy, and meat are time-sensitive and can only be transported for a short time to maintain freshness. However, as a major livestock-producing country, Australian production of dairy and meat products can meet the needs of the domestic market. As a result, Australian supermarkets and grocery companies have an advantage in developing the domestic market. Coles has developed such a high market share due to its high-speed transportation and scale advantages. At the same time, it is able to achieve a higher quality domestic supply chain at a lower cost.

Historical Factors. The first Coles store opened in Victoria in 1914, while Woolworths, another national oligopoly in the industry, was established in 1924 and listed on the Australian Securities Exchange in 1993. After nearly 100 years of development, operation, and management, these two Australian domestic companies have established a sound management system. Furthermore, they have developed brand awareness in the Australian market, established a good brand image, and won consumers' loyalty. This has laid a solid foundation for development in the domestic market.

Competition. Supermarkets compete primarily based on price (IBISWorld, 2022)[9]. Coles has been enticing consumers with massive discounts to stay competitive in the industry and maintain market share. With the rapid growth of newer retailers like Aldi and Costco, the trade landscape of the industry is constantly changing. At the same time, supermarkets also have to compete with specialty food retailers, and convenience based on store location may be a competitive advantage for specialty retailers over grocery industry operators. External competition has grown faster than internal competition over the past five years (IBISWorld, 2022)[9]. As a result, industry competition will intensify in the future.

Barriers to Entry: The Australian supermarket and grocery industry has high barriers to entry because the industry is so capital intensive. Opening a new store or buying a franchise license is expensive. Therefore, entry into the industry requires strong capital support to pose a competitive threat to incumbent industry operators. ALDI and Costco have successfully entered the Australian market as large multinational companies because they already have the scale and financial resources to enter mature markets. In addition, the dominance of the major players in the industry constitutes a barrier to entry. As oligopolies in the sector, Coles and Woolworths hold a significant market share, making it impossible for new entrants to compete. In addition, limited product differentiation among competitors further hinders the entry of new players.

Market Regulation.

Law and Regulations. The Australian supermarket and grocery industry has an oligopolistic market structure in which four major players dominate the market. Other small companies and Australian farmers need help accessing the highly concentrated domestic market. In 2015, the ACCC charged Woolworths with unethical conduct towards supermarket suppliers. One of the ways Woolworths tried to reduce its expected profit gap was to devise a scheme called 'Mind the Gap', in which it contacted B-tier suppliers and asked them for payments to support Woolworths (ACCC, 2015)[1]. Therefore, to maintain fair competition in the industry, ACCC used the "Australian Consumer Law" to supervise these actions and maintain good order in the market. As the Australian market's primary regulatory and law enforcement agency, the ACCC protects consumer rights and maintains healthy competition and supply-demand relationships in the industry (Greenleaf et al., 2019)[6]. In the event of unfair market competition, the ACCC will manage the situation under the law. ACCC-related laws also include the “Grocery Act”, the “Trade Practices Act”, and the “Transactions (Permitted Business Hours) Act”.

Anti-competition cases**.** An oligopolistic market structure can be unhealthy. Malicious pricing strategies and product misinformation are the most controversial issues facing the Australian supermarket and grocery industry. Coles Group has also been charged by anti-competition groups for similar issues and was investigated by the ACCC in 2015. The investigation found that Coles was selling bread advertised as “baked today, sold today” or “baked fresh in-store” even though the products were partially baked and frozen outside the store by suppliers and then processed in Coles stores. Coles was using this promotion to undercut the market share of its rivals and other retail bakers. This constituted a severe breach of Australian consumer law and created tough, unfair competition in the market.

In order to better regulate the market, anti-competition organisations began to play a role in the market. These organisations helped to reach the dark corners of the market that the ACCC and other relevant market enforcement departments cannot supervise. For example, anti-competition organisations discovered Coles’ false advertising regarding freshly-baked bread and reported them to the ACCC immediately. According to the ACCC’s investigation, the court ordered Coles not to declare on its packaging, signage, website or other promotional materials that bread products are fully baked on the day of sale or baked with fresh dough for three years (ACCC, 2015)[2]. Under the supervision of anti-competition organisations, the market environment has gradually improved.

Consumer Preferences in the Market.

Australian consumers have many choices when it comes to shopping for everyday essentials. They can choose a supermarket closer to home or a supermarket with a wider variety of products. Most consumers prefer a supermarket with lower prices for the same product quality. An example of consumer preference is modelled in Figure 5. The model describes how consumers choose between different supermarkets when using their income to buy two goods (shampoo and conditioner). Suppose Coles has a promotion on shampoo and conditioner, such as buy a bottle of shampoo and get a free bottle of conditioner. At the same time, Woolworths has no advertisements or discounts on these two items. As shampoo and conditioner are complementary products and daily necessities, most consumers will be inclined to purchase the combination of goods sold by Coles. Therefore, the budget constraint is widened, and the optimal bundle is higher, which means that the consumption of both goods increases. This is a simplified example, and many other factors affect consumer preferences, including branding.

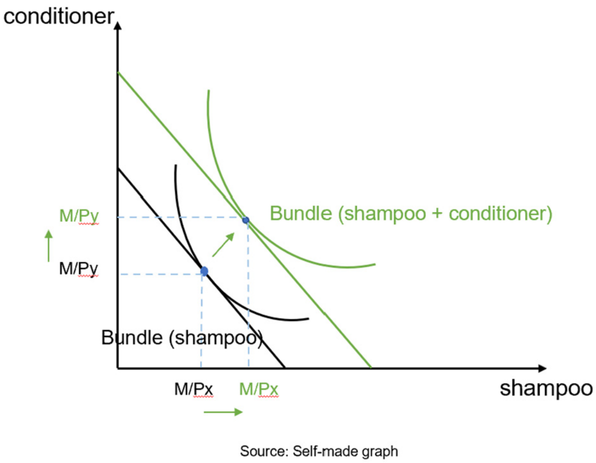


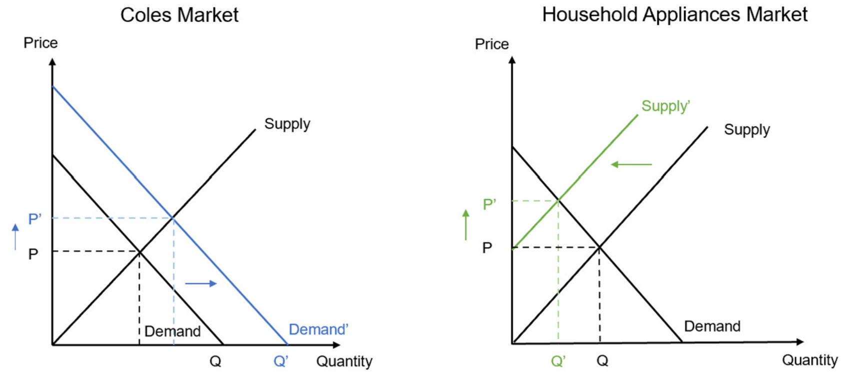
Fig. 2. Consumer's Optimal Bundle

Price Elasticity in the Market.

Most of the goods sold in supermarkets and the grocery industry are daily necessities (Andreyeva et al., 2010)[3]. The price fluctuations of daily necessities are relatively small, and there is significant fixed demand. Therefore, daily necessities don't experience a lot of price elasticity. Coles mainly sells vegetables, fruits, meat products, and other daily necessities, so the products sold by Coles have less price elasticity.

Industry Integration and Equilibrium.

Coles is currently focusing on growth in the supermarket and grocery industry. However, there could be spillover effects if Coles consolidated with other industries, such as home appliances. From Figure 3, home appliance brands can place some of their products, such as microwaves, refrigerators, and dishwashers, in Coles supermarkets. Increased opportunities to see household appliances while purchasing daily necessities may increase sales of household appliances. As shown in Figure 6, the expansion of consumer demand via Coles supermarkets leads to an increase in the price of household appliances. At the same time, the supply of household appliances in the market decreases, and the supply curve moves to the left to promote the price rise.



Source: Self-made graph

Fig. 3. Spill Over Effect Between Coles Market And Household Appliances Market

Year	Revenue $b	Growth % change
2011-12*	24.4	N/C
2012-13*	25.7	5.3
2013-14*	26.3	2.3
2014-15*	27.7	5.3
2015-16	29.3	5.8
2016-17	29.8	1.7
2017-18	30.0	0.7
2018-19	31.0	3.3
2019-20	33.0	6.5
2020-21	33.8	2.4
2021-22*	34.8	3.0

Source: Annual Report and IBISWorld
Note: *Estimate

Fig. 4. Coles Group Limited – Industry Segment Performance [5] [8]

2.2 Firm Analysis

Cost Structure.

Coles has always operated a capital-intensive business model and has invested heavily in capital upgrades. In addition, Coles Group is one of the largest employers in the Australian market, with approximately 120,000 employees. Coles has made other strategic moves over the past five years, including expanding its range of prepared foods, investing in supply chain automation, expanding online sales, and undertaking store refurbishments. Figure 5 shows that between 2020 and 2021, Coles was affected by ovid-19, and the revenue growth rate grew slowly. Nevertheless, it has also benefited from a surge in consumer demand for groceries during the Covid-19 pandemic, and its earnings have been able to keep growing.

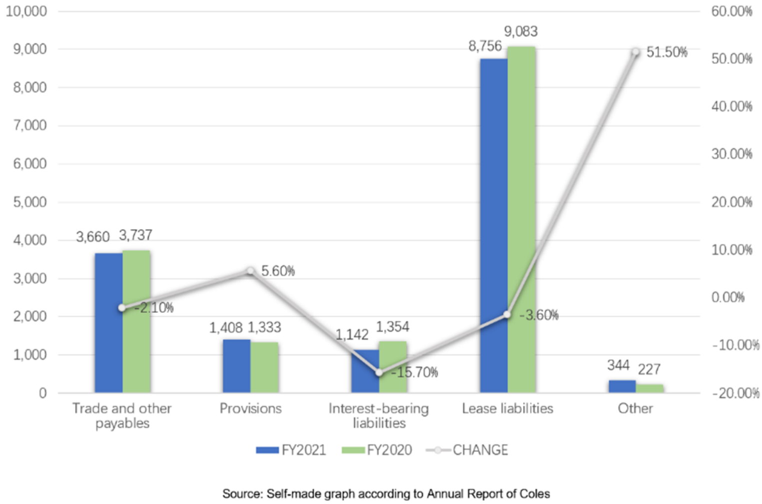


Fig. 5. Cost Structure Of Coles In 2020 And 2021

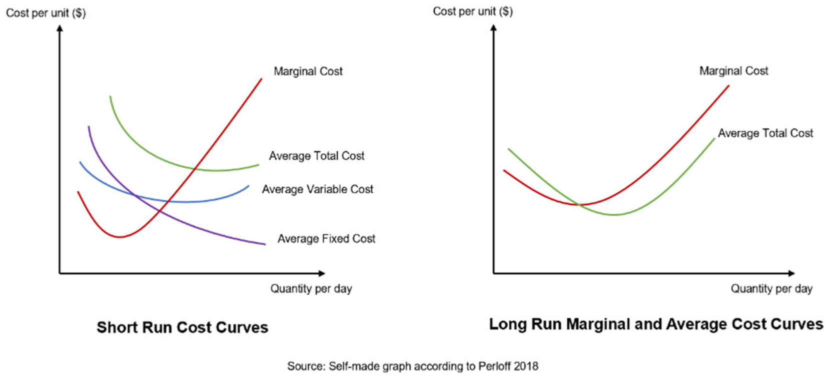


Fig. 6. Example of short and long run cost curves

Coles has a larger operating scale and a larger market share than other companies in the industry. Coles Group companies.

provide consumers with a variety of products. The input of production factors is an essential part of the regular operation of every company. The more significant the proportion of a specific production factor input in a company's total cost, the more it will become the leading business risk (Jabbour et al., 2019)[10]. Figure 2 shows that the proportion of lease liability in Coles Group's cost structure is too high, accounting for about two-thirds of the total cost. This is because Coles is one of Australia's largest supermarkets, with nearly 1,000 stores. Therefore, lease costs have become Coles' most crucial production factor, which has also become the main risk facing the company's operation.

Coles faces various costs in its short-term operations, including leasing, transaction payments, and sunk costs, the latter of which is the most significant. Since Coles is a labour-intensive industry and employs a large number of employees, wages are also a sizeable variable cost that the company needs to face. As shown in Figure 4[5] [8], the short-term cost structure varies greatly, but the company has certain economies of scale in the long run. Coles Group continues to expand in the Australian market, nearly exceeding 1,000 outlets. With the continuous expansion of its scale, Coles' average cost will gradually decrease as its sales volume increases. In addition, Coles Group also has economies of scope. Coles sells many different types of goods, and the diversification of products can meet the needs of consumers. In addition to the supermarket division, Coles Group also operates alcohol retail and convenience store brands, including Liquorland, Vintage Cellars, and Coles Express, thereby gaining a marketing advantage and delivering the satisfaction demanded by target markets more effectively than its competition.

Price Structure.

Price discrimination is a pricing strategy used by monopoly firms to obtain excess profits through differential prices (Bonatti & Cisternas, 2019)[4]. Coles uses price discrimination in market competition. They sell the same item at different prices in different cities and regions. For example, Coles stores in Sydney and Melbourne sell items at slightly higher prices than in Brisbane. Coles store prices also vary in different parts of the same city, with Coles stores closer to the centre being more expensive than Coles stores closer to the suburbs. For example, in 2015, Woolworths quietly changed thousands of website price tags to match those in stores to Internet shopping and charged a premium (Herald Sun, 2015)[7]. The same thing also happened at Coles.

Advertising.

Coles previously focused on paper advertising, launching a weekly product discount guide for consumers. Now, Coles is planning to eliminate paper advertisements and push digital discount information to reduce costs and provide consumers with more personalised choices. In addition, Coles has placed advertisements on LCD advertising screens in shopping malls and bus stops. Furthermore, Coles uses social media such as Facebook and Instagram to target younger consumers.

3 Conclusion

The supermarket and grocery industry in Australia is an oligopoly. Coles Group has a significant market share as one of the largest supermarkets in Australia. However, the continued expansion of Aldi and Costco has weakened Coles' market share and increased market competition. Coles Group's economies of scale and scope have helped it to reduce marginal costs and keep it ahead of market competition. In addition, although it is challenging to determine consumer preferences, it is possible to use consumer psychology to bundle products. The transformation of Coles' advertising has expanded its audience to young consumers, and the use of the Internet can provide consumers with more personalised information. Aldi and Costco have newly entered the Australian market and performed strongly in the market competition. Therefore, Coles needs to accelerate industrial optimisation and improve its supply chain to lay a foundation for further development amid increased market competition.

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