TRANSCRIPT

ECONOMIC, EDUCATION, JOBS AND SKILLS COMMITTEE

Inquiry into fuel prices in regional Victoria

Melbourne — 13 November 2017

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Witness

Mr Mark McKenzie, Chief Executive Officer, Australasian Convenience and Petroleum Marketers Association.

The CHAIR — Mark, welcome. Welcome to the public hearings of the Economic, Education, Jobs and Skills Committee's Inquiry into fuel prices in regional Victoria. All evidence taken at this hearing is protected by parliamentary privilege. Any comments you make outside the hearing are not afforded such privilege. Hansard is recording today's proceedings. We will provide a proof version of the Hansard transcript so you can correct any typographical errors. I would like to invite you now to make your presentation or statement, but please state your name before you start and allow us some time to ask questions.

Visual presentation.

Mr McKENZIE — Sure. Thanks, Mr Chairman. Committee members, my name is Mark McKenzie. I am the CEO of the Australasian Convenience and Petroleum Marketers Association. We are the national peak body that represents fuel retailers and wholesalers in the country. I should stress that there is one element of the industry we do not represent, which are the company-owned operations of the majors, so we are talking here about Shell, Viva, Caltex and BP. We actually work with their dealer members and we also work with the supermarkets. So effectively our members, as we have identified in the submission, range from the very big, like Coles and Woolworths, right down to the small business operators operating in the central towns of Bendigo and Ballarat. It is a really interesting mix of members to deal with, with a lot of dynamics. You have heard certainly from one of our members, APCO, talking about some of the issues.

I am assuming that you have read the submission; I am happy to take any questions in relation to it. But I suppose the central issue I want to focus on today is just why petrol prices vary, and I have got a very short presentation, which I am just going to flick through really quickly. We actually gave this presentation to the Queensland Government when they called their fuel price summit. I suppose the central question you are going to be getting in here consistently is: why do they vary? Certainly when we look at the charter of this Committee, it is a case of: why is there a difference between regional and metro? I suppose the very first thing to actually talk about is one of the things we frequently deal with. I sit on the ACCC fuel consultative committee. This is all I do; my whole job is fuel. I have spent a lot of time following Rod Sims around. We do research on petrol prices, and the question you are asking is a question we spend a lot of time dealing with.

The very first thing I want to get across is there is no such thing as a homogenous fuel market. It seems to be a proposition that we buy fuel out of Singapore and that because it comes at the same price it should be the same price at the pump, whereas what we tend to see is like any market. You have got a whole series of discrete submarkets that operate like a patchwork quilt, each of them with their own characteristics in terms of population intensity, each with their own characteristics in terms of market volumes, that will all have a bearing on the types of businesses that actually operate. So the nature of competition within each of these varies, and as a result you will see variance in price.

But it also varies both between and within markets. Even within a capital city, while we will tend to quote, as you have heard from previous testimony, an average, what you basically find is that average is made up of a whole series of different prices that actually can swing by close to 15 or 18 cents a litre, and so what you are doing is you are picking an average within that.

Mr MELHEM — Just on that, a few months ago the price did move up and down by 20 cents. What is the logic to that?

Mr McKENZIE — The logic basically is you have got the competition dynamic that is actually playing out in a certain area. So what you have got is a group of retailers where someone has decided to discount and then they play follow-the-leader in discounting, whereas other areas that are not affected by that particular competition dynamic stay and maintain their own local market dynamic. Just because I am operating in the Mornington Peninsula, for instance, it does not mean I start discounting in Geelong, or if I am operating in St Kilda and I have got a service station and start discounting, it does not mean I am actually going to start discounting in Tullamarine, because each of those is operating with their own discrete local markets. This is a key issue that we struggle to get across and communicate as an industry, and I would be the first to say we have not done it very well over the last 10–12 years.

Mr MELHEM — Well, does that mean I am selling my product at a big loss?

Mr McKENZIE — I am going to go through that in a moment. I am going to show you through the price pendulum.

So we get variability within those markets. Let us look at a couple of fuel retailers. The easiest way I have had to describe it: you will hear people talking about a discount price cycle that is like a sine wave that goes up and down. So if you imagine waves coming at you, there is the trough of the wave and there is the peak of the wave. The way fuel retailers operate is they do not charge the same fuel price all the time, but they must secure a return over the 12-month period; they must average a return for every litre of fuel sold. But that does not mean that they do that every day. So we do not run with constant prices.

What they will tend to do in a local market is get to a situation where someone might decide to discount. Either they have got a liquidity problem or they have decided they want to get more traffic across their forecourt, so they actually discount their fuel. So if I discount my fuel and you four are in my local market area, you will follow me and we will play a game of leapfrog: I discount a cent a litre, you discount a cent a litre; then I discount a cent a litre, you discount a cent a litre. And so the process goes and we go down the hill, so to speak, until for one of us the pain gets too much—that is, I am losing too much money or I have got enough customers coming through my forecourt so I go up. A lot of criticism that you hear particularly from Labor MPs is they understand that we go down slowly and then all of a sudden we rocket up, but the result is that I am not going to inch up; I have just got to the point where the pain is too much and I have got a significant volume across my forecourt, so I will swing up and everybody else will follow me. And so what you do is you get this wave, which we will talk through in a minute.

Effectively what I am trying to do as a fuel retailer is balance the pendulum. So there is a point at which I get to a financial equilibrium. This was done on the 2015–16 figures; it is 9.5 cents per litre. As you have heard from the gents of APCO, that has tracked up quite significantly. There have been compliance costs, wage costs and even the cases like the cost of a retail site and the rent I am paying. We have seen energy costs go up by 80 to 120 per cent for service stations on a year-on-year basis, but that is across the board. For argument's sake, let us say it is at 9.5. What I will do in the fuel price cycle is I will discount. I will go to the maximum level that my pendulum will go—the maximum point of discount pain—before I swing right through to the high point of the cycle. And so this is why you get the variance, because you have got this pendulum going backwards and forwards. My ultimate aim is to be sitting at that point of equilibrium.

Certainly I would be so bold as to suggest that I think the majority of concern of Australians in relation to fuel price is actually about the volatility of price, not the quantum of price. They say, 'I walked in yesterday, and I bought it at $1.15. Now I'm walking in and buying it at $1.25. I got ripped off'. But when you actually start to look at the average, which is why the ACCC uses the average, it is actually the average that defines how much you pay. So, yes: 'I might be at $1.15, but my price should have been at $1.20. Next week I'm paying $1.25; it should have been $1.20'.

There has always been an argument there that maybe we should look at regulating price. I would say, if that is something that you are looking at—and someone was talking to you; I have not seen many of the submissions—all you have to look at is the economies that have regulated price. They track much higher. As you will see in our submission, by OECD standards we are the fifth lowest in relation to petrol price and the fourth lowest in diesel. That is a phenomenal testament to the competitiveness of this market, but it is done on the basis of the average price through the year, not the swings that you actually see here.

If we just jump to the next slide, what I want to do here is just talk about the petrol price cycles. They are not the same. They operate differently according to different markets. Here you see in Perth, which is the only market that is actually regulated, you have got a sawtooth shape that actually occurs, but in every other market the price cycles vary. So if I wanted to play games, if I was a motoring organisation and I wanted to actually criticise petrol price, I would make commentary at the high point of the cycle. If I am in the industry and I want to justify what my position actually looks like, I make commentary at the low point of the cycle, which is why the ACCC focuses on the average.

If you just have a look at the graph in the top right-hand corner, Melbourne swings. As you can see, it swings quite significantly. In regional areas it does not swing as much. There is a little bit of a petrol cycle, but it tends to stay fairly constant. So if you imagine I drew a line in the middle of that, there are points at which regional petrol prices are higher than metro, and there are other points, as APCO made the point earlier in their testimony, where I am actually lower. And I note with interest that when this inquiry was actually called last year the ACCC five days later came out and talked about the fact that the gap between regional and metro had actually narrowed. I suppose the point I would suggest to you is that it is very easy by playing short-term games with the petrol cycle to actually draw small insights, but they are not necessarily valid of the market over a 12-month period. Really to actually look at what is going on with petrol prices, you need to look at the long-term.

I might close up the presentation at that point, but I have left you with some other information. I think one of the key things I would alert you to is that because this inquiry is actually regional, we are getting service station operators, particularly the smaller guys, to talk about the difficulty of servicing towns. So in some cases at the most extreme end where the retailers have not been able to maintain a regional margin—places like Newstead—the service stations have actually disappeared from the town, and the consequence of that is that those people now living in Newstead travel to Castlemaine on a round trip to actually fuel up. So the cost per litre of fuel is not their issue; it is the fact that they have lost an essential service.

I am not saying that if governments continue to regulate, you could get to a point where you can get more and more of those into a position where they can compete. But in the sort of dynamic that APCO were talking about earlier, those that are surviving are the businesses that are actually being very innovative with their fuel. They are actually looking at a broader market and they are actually looking to take very aggressive approaches to the operation of their market, but there are circumstances now where the pain is getting to a level where the margins are so lean that it is no longer viable to continue operating. And so I suppose our challenge is to ensure that we balance profitability and return for the assets while also maintaining that we have an essential service effectively to deliver to regional residents.

Mr Chairman, I am going to leave it there. The majority of my report talks about, I suppose, the central focus here, which is to actually say that costs of a service station do not vary markedly between metro and regional areas. In fact in a regional area things like electricity tend to be higher per unit of use. The big determinant in relation to what margin I need to secure is based on the volume that I am actually selling. So a service station, a very small operation with a two-pump facility and a general store operating north of Bendigo might be doing 1.5 million litres, whereas the service station that you see running out on the road towards Geelong just by the Bolte Bridge would be doing close to 25 million or 26 million litres of fuel. It is that variance and it is the size of the market that actually dictate how much of the fuel I have to capture to recover my costs, and you have got a spreadsheet in our submission which identifies the range. I will leave it there, Mr Chairman.

The CHAIR — Thank you, Mark. Your research shows that consumers choose fuel retailers based on the total site offering rather than the price.

Mr McKENZIE — Our recent research does, yes.

The CHAIR — What does your consumer research find in terms of price transparency?

Mr McKENZIE — I presume you are talking about a 2017 monitor of consumer attitudes. In that research we were comparing the benchmark with what we discovered in 2015. The research still tells us the price is the number one determinant of site location. However, what it does suggest is that in 2015, 60 per cent of motorists nominated price as being the key determinant of site selection. In 2017, two years later, it is now 40 per cent and we are starting to see issues like convenience—they are not overtaking price but they are actually increasing in their prominence in relation to site selection, which is why you are seeing investments from all the majors in actually starting to set-up cafe-style facilities and supermarkets. The independents are starting to do the same thing. Our entire industry is gearing up to respond to time-poor consumers that are increasingly seeing service stations as a point of more than just fuel.

I would suggest to you that one of the reasons that we have seen a decline in price sensitivity has been we have gone through a pretty constant period of oil prices in the last 18 months, so as a result we have not seen as much of the volatility. I am not for a minute going to say that is a long-term trend, but in the last 12 months we have certainly seen a change. But the big headline finding in our research was that 30 per cent of consumers indicated they visited a service station at least once a week and did not buy fuel. That is important in regional areas because increasingly they are becoming the general store. As a number of other areas are scaling down, service stations are seeing an opportunity to capture that lost ground.

The CHAIR — The research compared behaviours between regional and metropolitan consumers. What did they find?

Mr McKENZIE — It was 1000 respondents. They were weighted according to volume. It was right around the country, and it was weighted on a capital city and regional basis. We did not find any significant variation between regional and metro consumers, which was actually quite surprising to us and which is why it has not been lifted out in the major report.

Mr CRISP — I would like to talk to you about New South Wales FuelCheck. The NRMA claimed that since the introduction of FuelCheck Sydney fuel prices had been the cheapest in the major capital cities. Even if that is so, what is your experience with that? As I read it, they do not claim that to have occurred in regional areas.

Mr McKENZIE — That is right. I suppose, listening to Mr Setkiewicz's testimony earlier here, he did actually indicate a very important clarification on his answer to your question, and that was that FuelCheck now is actually capturing more data than previous data sources used to. Prior to FuelCheck we actually had a couple of systems—predominantly GasBuddy, which has been mentioned, and MotorMouth—where effectively the prices that were reported did not pick up all the discounters, whereas now with all service stations required to report you have actually seen a lower average reported price.

But I will make this determination for you: FuelCheck has not lowered prices; what it has done is capture more data where it has been a weighted influence of the discounters, which has suggested that there is a lower average price. But in everything we have seen we see no evidence from the 18 months that it has lowered price. We also see no evidence that has actually increased price. Effectively if you have a look at the experience to date it is delivering an open finding for us. We have some concerns about the way it has actually operated, and we certainly note the OECD report, which for us is the most significant piece of research on these sorts of interventions, which actually suggests that it can lead to algorithmic collusion. This is where effectively I am able to respond much faster because we are getting a real-time signal that my competitors have changed price, so I will change price much faster, so as a result you do not end up with a lag; everyone is changing around the same time. So I do not get the benefit as a consumer of the lag that would actually occur where some of them might take half a day to be able to identify that their competitors have actually changed their position.

But I should stress that our industry has no problem with fuel price transparency. We have had Informed Sources for a long time. We have got GasBuddy. These are actually funded by industry; they are supported by industry. Our principal issue with FuelCheck is that if you introduce a government law and a compliance regime it needs to be appropriately resourced and it needs to be appropriately enforced.

Mr CRISP — On compliance costs, you are saying that New South Wales FuelCheck has not added to the price, but also in your submission you said that fuel price increases resulting from legislation has added considerable amounts of pricing. So if it is not FuelCheck, what is it?

Mr McKENZIE — In New South Wales we have seen a raft of environmental compliance—ethanol compliance—that have been put in place. I suppose what gets lost in all these debates is that our industry is made up of businesses, the vast majority of which are small businesses. So when you actually introduce a law like an environmental law that says, 'I've got to introduce price monitoring systems around my wells to actually allow the early identification of pollution into the ground and actually sink ground wells', that is going to cost me money—$60 000 to $80 000 a site. If I am introducing things like vapour recovery, where I actually capture the vapours that are coming through the fuel pumps, I have to install a system on each of the dispensers to suck it back in so I can capture it in the ground and put it back into the tanker so it does not go into the air. At the moment the average we are seeing is around $200 000 for a six-dispenser site.

All these costs are put onto the business. Every time government legislates in these sorts of areas they are adding costs. I suppose one of the ultimate challenges for our industry is quite often industry will try to absorb as much of that as it can, because we are operating in a fiercely competitive market. Unless it is felt by everybody, I have got a look at very creative ways of financing this. So rather than looking at a commercial payback of three years, it might have added 4 or 5 cents per litre, I am trying to amortise this through my own capital or by changing my gearing ratios over a 10-year period. We are seeing a raft of regulations—the ethanol regulations, vapour recovery, UPSS. FuelCheck itself has brought some costs, although I would say it is probably relatively minimal. I suppose it might be very odd to me to say, representing the industry, that really the issue for us with FuelCheck is not cost, because predominantly what you are able to do is remove the spotters that you used to use—someone who was actually employed on a part-time basis to run around service stations and check that my price was actually competitive. Now I have got an app set up by government which gives me real-time prices that will alert me every time someone changes prices. So in fact, while there is the cost of set up, the ongoing costs actually means that largely it is a neutral benefit for me.

Mr CRISP — And what leads from that is the ACCC have made some conclusions on fuel prices, and you have given some indications there.

Mr McKENZIE — Yes.

Mr CRISP — You are critical of some of their recent conclusions on prices. So what is the ACCC missing in their analysis?

Mr McKENZIE — The ACCC effectively is tracking what we call GIRD, the gross indicative retail difference. If you have heard me on the media with Neil Mitchell or Jon Faine, basically what we have seen is that the ACCC is reporting on the fact that this difference between the terminal gate price, the price I buy wholesale, and what I sell at retail on an average basis is climbing. What we have been at pains to suggest is that the ACCC is not tracking movement in costs. You heard just a moment ago in terms of the fact that retail is experiencing increased costs. So the last time the ACCC did a detailed review of costs and prices of fuel retail was their in-depth study that was actually done in 2014. We have not seen anything done since that time.

My energy costs have gone up. As I said, on a year-by-year basis at the moment our retailers are reporting an 80 to 120 per cent increase in electricity costs. Our wage costs are continuing to go up, albeit they are small, and our rents have gone up. So if you are operating in a site, the capital value of service station sites has dramatically increased in recent years, and the rents are reflecting that. So effectively those costs are being passed through. Our concern, and the question we have asked of the ACCC, is the need to actually map how the costs have actually moved as well. Because the gross indicative retail difference only picks up the revenue change; it does not pick up the cost change. And that has been our criticism. But it is a deeply difficult exercise to do, and I suppose if it comes to priority, and it is something that we actually said recently at the fuel consultative committee meeting, we would much rather that the ACCC look at the structure of competition and the issues associated with that, and we have a very big development going on at the moment with the BP-Woolworths acquisition. Our concern is that they get it right. So, if for the sake of those sorts of arguments we have had to put them aside while they concentrate scarce resources on the main merger stuff, for us that is a higher priority.

Mr MELHEM — Just on the last point, the competition aspect, the shopper docket, for example, is that a good thing or a bad thing for your industry?

Mr McKENZIE — Extreme shopper dockets are a bad thing for the industry. Our association was one that was partnering with a number, including the master grocers, that fought hard for the ACCC to cap the 40 and 20-cent-a-litre discounts that were actually offered. I suppose it is important—people talk about the shopper docket—but the key thing that the ACCC attacked in relation to the shopper docket was what was called stacking. This was where I was charging—allegedly—you more on your supermarket buy to actually then subsidise your fuel buy. The ACCC deemed that that was not something that was available to people who do not own supermarket chains, and therefore it was deemed illegal. What they did was introduce a cap on shopper dockets, and we have largely seen that operate for some time. There have been some questions raised in industry of late about some of the covert marketing using loyalty programs that might see a possible material breach of that undertaking, but largely within our membership it is still an area that the independents and the smaller guys continue to be concerned about. But ever since the ACCC undertaking was introduced we saw a swing back to the independents, the smaller retailers and the non-aligned, non-supermarket retailers. That was of the order of 12 per cent in the first two years.

I suppose what I would be suggesting there is that for the research that we do, such as the monitor of attitudes that the chairman identified earlier, we are seeing that motorists are becoming a little more savvy in relation to the way these things are actually operating, and we are pretty confident that the undertaking of the ACCC has actually set a precedent here against stacking. It is not to say that discounts should not be available. They certainly should if the opportunity is there, but they need to be borne by the fuel retail business, and that was the principle that the ACCC had identified through its investigation.

Mr MELHEM — I can give you an example. I still see that the Uniteds of the world are cheaper than BP and Shell. It is clear as day. So if they can actually sell on average about 5, 6 or 10 cents cheaper than the big ones, why can't the big ones match it? That is why I am a bit concerned now. If BP are going to buy

Woolworths and grow the monopoly, is it going to be good for business or bad for consumers? The track record is not …

Mr McKENZIE — I come back to the point I made before. This is a competitive market. Just like any business, I can actually utilise my brand—my brand has certain characteristics. Each of the brands and the individual majors will tell you that they have a certain personality that attracts consumers. There are some people that will never buy at United because there is just something about the brand they do not like. So effectively each independent retailer has identified what they think works for them in terms of their formula, and they will actually run that to the hilt. Now, there are some brands that their principal characteristic and the personality of their brand is discounting, and that is how they attract people. There are others who say, 'I'm a premium product and I'm a premium service. When you come to my site it is a bells and whistles site'—everything. Their restrooms are actually clean. 'I've got a full diversity of convenience offerings, so I'll attract you with other things'.

I suppose it boils down to the fact that if this market was truly 100 per cent price sensitive, then the question—and one that I often get my members say—is that they do not get rewarded for discounting. They discount to the hilt, and at any time in the market you will generally be able to find the smaller guys or the independent guys that will be running at 8 to 10 cents a litre less, because they believe they have to do that to attract people, because the other elements of their brand are not strong enough to do that. Then what we are starting to see at the moment in the market is the move to petrol and convenience. This combination is actually creating opportunities for very dynamic and innovative operators. You saw on a couple of slides in the previous hearing where you are really starting to see now a bit of a flavour that people are utilising the convenience offer and cafe-style food to attract people. Fuel becomes less of the buy.

I will just leave you with one note which was recently in the consumer research we talked about. Five cents a litre on a 40-litre fill, which is the average, is $2 a week. It is half a cup of coffee. So while we will talk constantly—and quite rightly so—about what the long-term average boils down to, the quantum of difference here from a consumer's mind, we are starting to see a bit of a change. There are more fuel-efficient vehicles, a greater proportion of hybrids and the growing influence of tolls. From our view we are starting to see a little bit of push back in terms of the price of fuel not being the only factor I consider when I am going to a service station.

Mr MELHEM — Have you got any view on fuel security—more refining in Australia or less refining? Is there a preferred option? Have we got the balance right—because it has gone the other way: less refining and more raw …

Mr McKENZIE — I would suggest that is probably an issue for the AIP, and I will defer to them. We do not tend to comment on that level, but I will say this one thing: if you think about the late 70s and early 80s, where we used to have significant blockages, most of that was done through industrial unrest. If you actually have a look at the findings of the Senate inquiry into fuel security—I know there was one run here—what we effectively now have is we are not dependent on a single source; we have multiple sources of fuel coming into this country. Effectively what it is really about is not whether it is made here or not but the fact that we have surety and reliability of the supply that is coming in. If we get to a situation where all 30 or so portals of fuel coming into this country are actually blocked by some sort of geopolitical event like a war, we have got more problems than just fuel, in my view.

To us at a retail end, we tend to have more interruption created by things like if I take a trucking fleet that has had some safety consequences and I ground it. When we had the incident with Cootes, the reason our service stations were unable to get some fuel had nothing to do with whether fuel was in the country; it was trying to transport it from the port to the service station. For us, that is a bigger issue than the broader energy security.

The CHAIR — Mark, one regional resident suggested that the Victorian Government promote the establishment of community-owned service stations. What are your views on this?

Mr McKENZIE — There are a couple of people who have had a go at it in the past. I cheekily quite often say to the motoring associations when they criticising us for price of return, 'Well, come into the market'. We are not at a point here where we are saying it is only the key participants who are in play. The reality here, though, is that really you are operating in a market that operates on wafer-thin margins. Contrary to public perception, the long-term average retail margin has gone up a little bit, but the last time it was done by the

ACCC the all-industry average was at 5.2 per cent and the service station mark was at 3.6 per cent, so it is actually lower in terms of net profitability than in terms of all-industry. It is a difficult game.

We have had a couple of service stations—I just cannot recall the name, but there have been two attempts here in Victoria, up in the north-east, to try and get community service stations up. But the issue has really been about how you deal with all the regulation. This really is a situation where this is a professional discipline and a professional industry. Managing that issue in terms of supply, price and cash flow gets very difficult and community structures tend to struggle with that. If it was something that the government wanted to involved with, I suppose the concern we would have as an industry would be to make sure it does not distort competition.

Quite apart from the fact that we have had the ACCC for 12 years now review our market, and all our retailers are required once a year to provide information there, it has dealt with and consistently delivered a clean bill of health, I think that has led to some people saying, 'Well, that means the ACCC is actually toothless'. I would argue that it is saying, 'No, this is a very competitive market'. Therefore a community-run enterprise does not generally have the management capability to run with that competition dynamic. That is not to say I would preclude it in any way, but we would certainly raise our eyebrows if the government were actually intervening in the market like that, because there is a risk of distortion and adverse consequences.

The CHAIR — If there are no further questions, Mark, on behalf of the Committee, I would like to thank you for your time and contribution.

Mr McKENZIE — Thank you very much.

Witness withdrew.