Australian Government
Productivity Commission

Relative Costs of Doing Business in Australia: Retail Trade

Productivity Commission
Interim Report

June 2014

This interim report has been prepared for further public consultation and input.
The Commission will finalise its report after these processes have taken place.

This publication is available from the Productivity Commission website at www.pc.gov.au. If you require part or all of this publication in a different format, please contact Media and Publications.

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au) or by contacting Media and Publications on (03) 9653 2244 or email: maps@pc.gov.au

Opportunity for further comment

You are invited to examine this interim study report and comment on it by written submission to the Productivity Commission, preferably in electronic format, by **Friday 11 July 2014**. Further information on how to make a submission is included on the study website listed below.

The final report will be prepared after submissions have been received and will be forwarded to the Australian Government in early October 2014.

Commissioners

For the purposes of this study, the Commissioner is:

Patricia Scott

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Terms of reference

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 4 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission undertake a study into the cost structures of the dairy product manufacturing industry and the retail trade industry, including costs relative to international competitors, where relevant.

Background

A sound understanding of the cost structures of Australian businesses, including costs relative to any international competitors, can provide valuable insights for considering policies to support living standards and economic growth.

Scope of the research study

In undertaking the study, the Commission should:

1. Undertake a case study of the costs (such as costs relating to capital, labour, intermediate inputs including energy, taxation, superannuation and/or regulatory compliance) facing businesses operating in Australia in the dairy product manufacturing industry and in the retail trade industry.
2. Where relevant, identify areas of cost disadvantage and disadvantage for these businesses compared to international competitors.

Process

The Commission should consult as appropriate and provide an interim report drawing on submissions and a final report.

The interim report should be published within two months of receipt of this terms of reference. The final report should contain findings and be provided to the Government within six months of receipt of this terms of reference.

The final report will be published.

J B HOCKEY
Treasurer
7 April 2014

Contents

Abbreviations

ABS	Australian Bureau of Statistics
ATO	Australian Tax Office
AUD	Australian Dollar
ANZSIC	Australian and New Zealand Standard Industrial Classification
CPI	Consumer Price Index
GDP	Gross Domestic Product
GFC	Global Financial Crisis
LP	Labour productivity
LVT	Low value threshold
MFP	Multifactor productivity
NCP	National Competition Policy
PC	Productivity Commission
RET	Renewable Energy Target
RTPI	Retail Trade Producer Index

KEY POINTS

Key points

The costs of doing business in the retail sector are inflated by unnecessary regulations, and governments' progress to address costly anti-competitive provisions has generally been slow and patchy.

What governments can do

- The costs of doing retail business — the subject of this study — are largely driven by geography, markets and commercial decisions.
- However, there are some costs that are heavily influenced by government regulations such as those affecting trading hours, the transport and delivery of goods, utility charges, product labelling and food safety. These cost pressures are accentuated in an environment where retailing is becoming an increasingly globalised business.
- Submissions and discussions in this study have already highlighted the desire by retailers and some commercial property owners for governments to progress implementing the recommendations of the Commission's 2011 inquiry report on the Economic Structure and Performance of the Australian Retail Industry.
- That report's recommendations went to areas where governments could remove unnecessary impediments to domestic retailers responding to the heightened level of competition.
- This interim report provides a short stocktake of progress on those recommendations. This study provides an opportunity to update information on the often unintended cost impacts of government regulations.
  - Many of the 2011 recommendations are matters for the states and territories — but not exclusively — local governments and, in some cases the Australian Government, are also involved.
  - Participants have generally been critical of the overall lack of reform since 2011.
  - All jurisdictions have initiated reform processes but few have achieved substantial reform — Victoria stands out as the exception across the various areas identified by the Commission although the reforms are incomplete. In

some cases, reform processes have progressed to consultation and review stages but no further.

  – The pace of reform differs materially across jurisdictions and significant regulatory inconsistencies remain. Some retailers are clearly frustrated about the progress of reforms already reviewed in detail.

- Current and proposed reviews at the Commonwealth and state level — notably the current review of competition policy and the forthcoming review of workplace relations — provide further opportunities to identify issues that affect competition and productivity in the broader economy.

A diverse and dynamic industry

- In 2012-13, the retail industry contributed $68.5 billion to Australia’s value added (or 4.9 per cent of GDP) and employed about 1.2 million people (or 10.5 per cent of total employment).
  – The industry is large and diverse in terms of size, product range, business models and formats, and cost structures.
  – The number of businesses is currently at around 133 000 with significant entry and exit over recent years.
- Retailers are operating in an increasingly dynamic and globalised environment, competing on different platforms and across borders — which has undoubtedly delivered better outcomes for consumers.
  – Technological, social, economic and demographic factors are changing what consumers buy, where they buy and how much they are willing to pay. The uptake and development of e-commerce is challenging the conventional tradeoff between price and convenience. Online offerings can be both cheaper and more convenient.

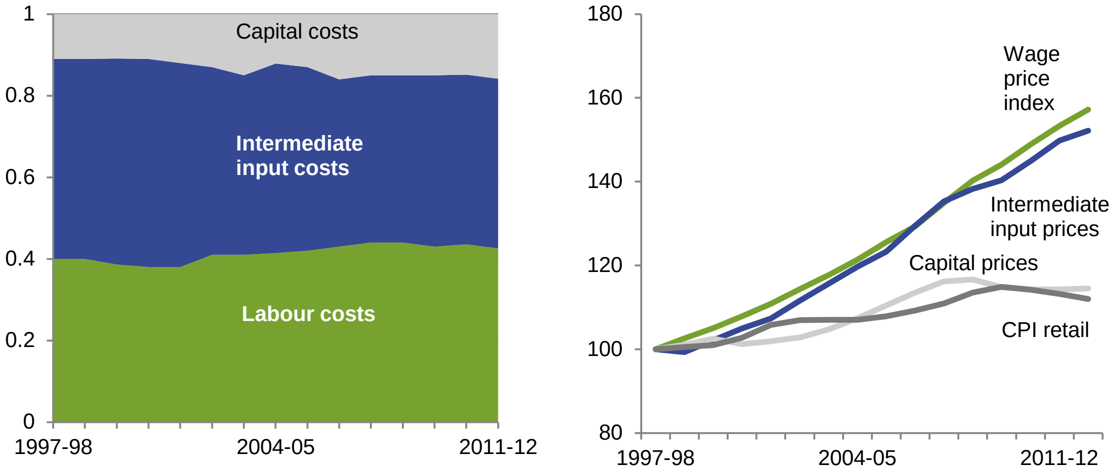
… where cost pressures are increasing

- Labour costs are the single largest area of expense for most retail businesses (figure 1). Concerns raised in submissions and in discussions with participants have included the level of wages, the growth in real wages, penalty rates, labour on-costs (workers compensation and superannuation), the costs of negotiating enterprise bargaining agreements and inconsistencies in Fair Work Act outcomes.

- Over recent years prices of labour, rent and energy have risen by more than the retail price index (figure 1). As a relatively labour intensive sector, retail is particularly exposed to increases in labour costs.
- Occupancy costs, including rent, also account for a substantial share of many retailers' costs of doing business in Australia. In this context, a number of submissions have pointed to what they view as unnecessarily restrictive approaches to planning and zoning by state and local governments as contributing to higher costs for retailers — both in terms of rents and compliance.
  - The Commission previously estimated that reforming development assessment processes that apply to commercial and industrial sector applications (which includes applications for retail space) could generate net cost savings of around $240 million per year.

Figure 1 **Retail labour and intermediate input prices have increased relative to capital prices and final retail prices**

Labour and intermediate cost shares from multifactor productivity estimates (left panel);[a] Retail input price indexes and the Consumer Price Index, 1997-98 = 100 (right panel)



[a] Intermediate inputs include all non-labour inputs, excluding the costs of goods sold. Some of the main intermediate goods and services used in the retail sector include manufactured inputs, professional and administrative services; occupancy and rent; utility charges, and communications technology.

Data sources: Commission estimates based on ABS (*Estimates of Industry Multifactor Productivity, 2011-12*, Cat. no. 5260.0; *Australia System of National Accounts*, 2012-13, Cat. no. 5204.0); D'Arcy et al. (2012).

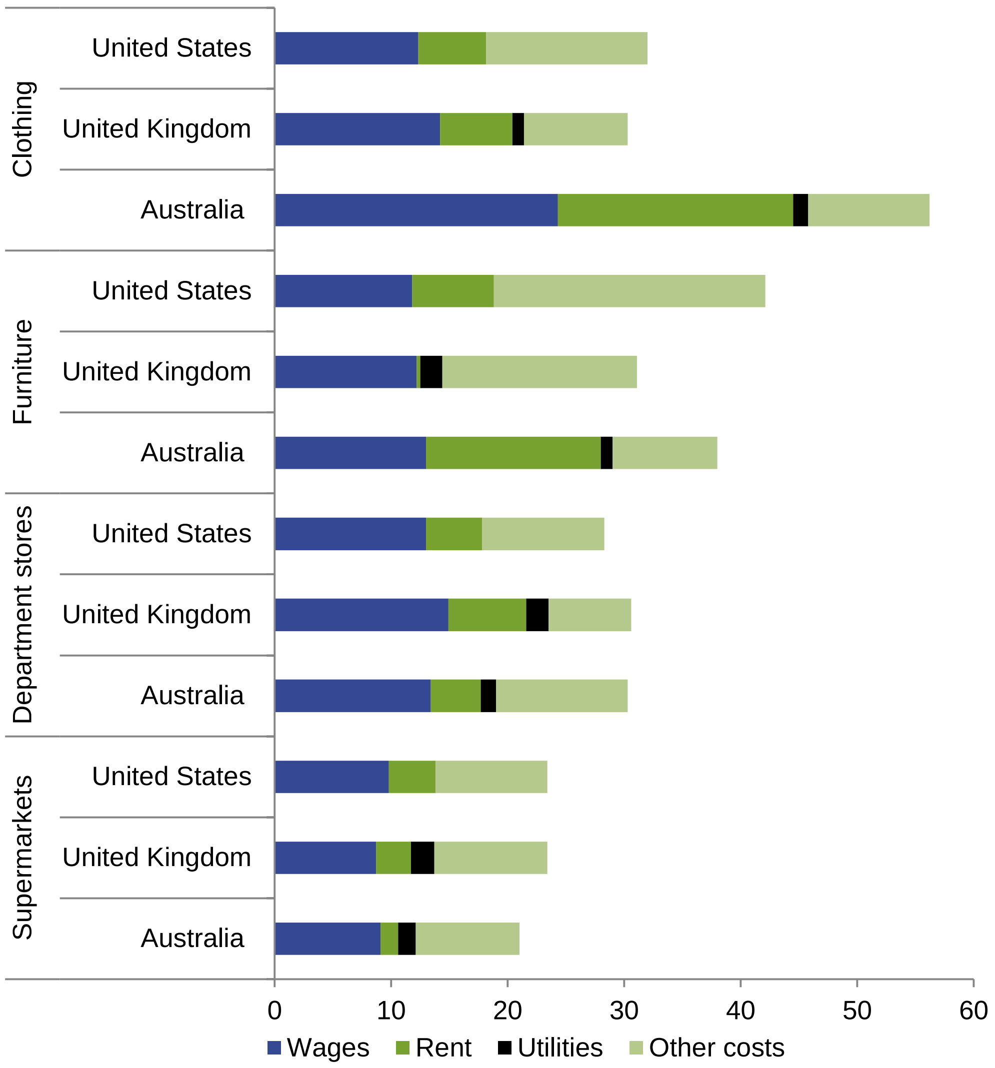
- However, cost structures are only part of the competitiveness story. There are many examples of retail businesses that have relatively high costs and are highly competitive, but in a world where consumers can go online at any time and buy products from global suppliers, cost pressures are more intense.

… but international differences in cost structures are less definitive

- There is a dearth of information available to allow accurate international cost comparisons and cost comparisons, where available, typically relate to segments rather than to the sector as a whole.
  - Partial data suggest that for some segments there are no discernible differences in cost structures between Australian retailers and those operating in broadly comparable markets overseas (figure 2). Caution is needed in interpreting this figure as service offerings may not be the same.
  - However, for other sectors, clothing for example, shares of labour costs and rent are much higher in Australia. Further work is needed to identify significant cost differentials and the Commission is seeking additional information on this matter.

Figure 2 **International cost structure comparisons, selected categories**[a]

Costs of doing business as a percentage of revenue[b]



a Utilities are combined with rent for the United States. Data are estimates for various years — 2013, 2013-14, 2014. **b** Excludes the cost of goods sold and profit.

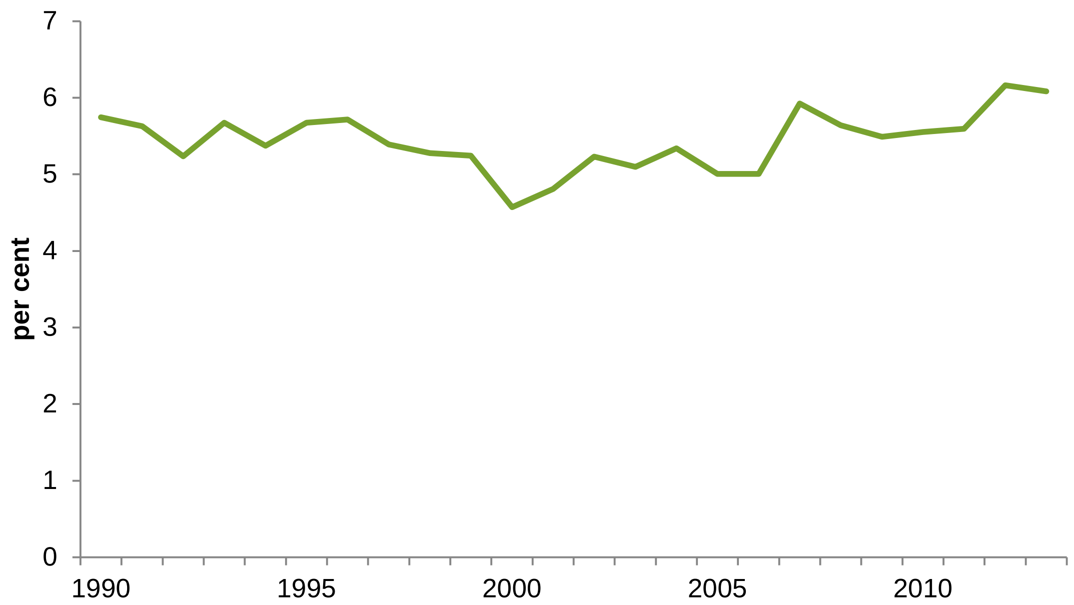
Data source: Ibisworld Industry reports.

Retail businesses are responding …

- The Commission's preliminary view is that the Australian retail sector as a whole appears to be managing these cost pressures effectively.
  - The evidence suggests that retailers' net margins have been relatively stable over the past two decades (figure 3).
  - There has been continued growth in investment and employment, notwithstanding a short term decline after the global financial crisis.
  - An increasing number of high-profile international players are investing in a 'bricks and mortar' presence in the Australian retail market.
  - Retailers are innovating and adopting a range of strategies to reduce their costs of doing business through the use of technologies such as self-assisted checkouts, a shift from casual to permanent staff, better supply chain management, the use of private label merchandise, energy efficiency measures and a move to online operations.

Figure 3 **Net retail margins have been relatively stable**

Gross operating surplus as a proportion of sales income, 1990–2013



Data source: ABS (*Australian System of National Accounts, 2012-13,* Cat. no. 5204.0).

- Many retailers are also striving for non-price points of difference based on a combination of service, quality goods, convenience and range. Some supermarkets, for example, are moving into new segments — offering sushi bars, barista coffee and a larger range of take-away/convenience foods.
- Nonetheless, there are further opportunities for Australian retailers to catch up with their overseas counterparts in relation to e-commerce and omni-channel marketing.

… within an environment that remains encumbered by unnecessary and costly regulations

- The sector has provided many examples of inconsistent, highly prescriptive and seemingly adhoc rules and regulations (see boxes 1 and 2 and chapter 4). The sector continues to labour under regulations that are out of synch with changing shopping patterns.
  - These include restrictions on trading hours across and within jurisdictions, and restrictions on what can be sold at particular times.
    - As an illustration, a retailer noted that 29 of its stores cannot trade on Sundays in Western Australia, South Australia and Queensland, leading to a loss of around 1500 trading days each year — equivalent to having a fully stocked supermarket closed for more than four years.
    - Queensland's Competition Authority estimates the net benefit of retail trading hours deregulation in that state of $200 million a year.
  - These also include costly or inconsistent regulations and, at times, their subjective interpretation, for issues relating to product labelling, food safety and delivery restrictions.
  - The Commission previously estimated the economy-wide benefits of 17 COAG business regulation reforms of almost 0.5 per cent a year in increased national output, and $4 billion a year in lower business costs.

Box 1 **One example of anomalous regulations**

In Western Australia regulations prevent Masters Home Improvement stores from trading in line with the hours enjoyed by other hardware stores. To be eligible to trade as a 'domestic development shop' Masters must only sell those goods which are prescribed by the *Retail Trading Hours Regulations 1988* (WA). The regulation prescribes a list of what a 'domestic development shop' can sell which gives rise to all sorts of inconsistencies and anomalies. The regulation:

- allows the sale of light bulbs but prohibits the sale of light fittings
- allows the sale of outdoor lighting but prohibits the sale of indoor lighting
- allows the sale of kitchen sinks but prohibits the sale of dishwashers
- allows the sale of wood-fire heaters but prohibits the sale of gas heaters
- allows the sale of indoor television antennae but prohibits the sale of outdoor television aerials.

The practical effect of the regulation is that Masters Home Improvement stores cannot trade as a 'domestic development shop' because it stocks both light bulbs and light fittings. Competitors who stock a smaller range of products are able to open for extended hours — thus placing Masters at a competitive disadvantage. The situation is an inconvenience for customers and an anti-competitive restriction.

Source: Woolworths (sub. 13, p. 2).

Box 2 **Another example of anomalous regulations**

In March 2010, the Premier of Victoria announced amendments to the *Control of Weapons Act 1990* (Vic) giving police new powers to search for weapons and banning minors (under the age of 18) from purchasing 'controlled weapons', including kitchen knives and plastic knives. These amendments were passed by the Victorian Parliament in August 2010. As a result of these amendments, from 1 January 2011:

- minors face an on the spot fine of $239 for buying knives, including plastic picnic knives, and a possible court appearance and fine of up to $1433
- retailers face a fine of up to $2389 for selling knives to minors.

These fines are enforceable despite the fact that minors can readily access the same types of plastic knives from takeaway food outlets next door to retailers.

Retailers have to ensure customers are over 18 when they purchase plastic knives. This means transactions have to be suspended to check customers' identification. This is more time consuming at self-service checkouts. Woolworths (sub. 13, p. 5) has estimated that across its supermarkets this ban increases its costs by $128 000 per year. Woolworths noted that no other state or territory defined a plastic knife as a controlled weapon.

On 8 January 2014, the Acting Premier and Treasurer of Victoria announced 36 'red tape reforms' following consultations with businesses by the Victorian Red Tape Commissioner. These 36 reforms included lifting the ban on the sale of plastic knives to minors. The Commission understands that legislation will be introduced shortly in the Victorian Parliament to that effect. In late 2013 Victoria Police advised the Victorian Government that pending an amendment to lift the restriction on the sale of disposable plastic knives to juveniles, police will not prosecute retailers in the interim. What is unclear is whether retailers have been advised of the policy.

Sources: Victoria Police (nd); Woolworths (sub. 13), Department of Justice, Victoria, pers. comm., 2 June 2014.

Information requests

INFORMATION REQUEST 2.1

What are the impediments to a faster adoption of e-commerce by Australian retailers?

INFORMATION REQUEST 3.1

The Commission is seeking further information on the costs of doing business (including costs of labour, capital, rent, energy, transport) across different categories of retailers operating in Australia.

- *To what extent have these costs changed in recent years?*
- *What is the impact of business size on cost structures?*
- *To what extent is e-commerce affecting cost structures? Which types of retailers are most affected?*

INFORMATION REQUEST 3.2

The Commission is seeking further information on relative cost structures between Australian retailers and those operating in comparable markets overseas.

- *How do the costs of doing business differ between retailers in Australia and those operating overseas?*
- *To the extent that there are significant differences in cost structures, what are the key drivers of these differences?*
- *To what extent are any cost differentials driven by the different mix of in-store and online retailing?*
- *To what extent are there differences in sales per employee between Australian and overseas retailers? What are the main drivers of any differences?*

INFORMATION REQUEST 4.1

The Commission is seeking further information on the impacts of planning and zoning laws on retailers' occupancy costs.

To what extent are occupancy costs also influenced by the behaviour of retail property owners?

INFORMATION REQUEST 4.2

How can state and local governments most efficiently accommodate the interests of both retailers and residents in mixed developments in relation to noise and other issues (congestion and safety for example)?

INFORMATION REQUEST 4.3

To what extent are retail sector costs adversely affected by changes to the pay rates of heavy vehicle transport drivers, and by other transport and freight cost issues?

INFORMATION REQUEST 4.4

In relation to all of the policy and regulatory drivers of retail sector costs under consideration in this study, the Commission is seeking further input and advice from stakeholders to help prioritise those areas where the prospects for achieving meaningful reforms are greatest, and where the potential cost savings and productivity improvements are also expected to be large compared with the costs of reform.

INFORMATION REQUEST 5.1

How have governments progressed against the 2011 Productivity Commission recommendations?

INFORMATION REQUEST 5.2

What has been the impact of recent reforms to retail-specific and generic regulation to date? Where the pace of reform has lagged, what are the barriers to reform and how could these be overcome?

- *To what extent could these barriers be attributed to the reform process?*
- *Where these barriers are considered sufficient to jeopardise the prospect of reform, what other approaches could provide net benefits to the community?*

INFORMATION REQUEST 5.3

What impact has the lack of consistency in the pace of reform between jurisdictions had on the costs of doing business in the retail sector?

Nationally harmonised regulation can bring substantial national benefits, but they can also impose disproportionate costs on smaller businesses, particularly those operating in one state.

- *What are the advantages and disadvantages for businesses operating across state borders of opt-in harmonised arrangements — with the existing state regulations being the default?*
- *Would a two-tiered opt-in system impose undue regulatory burdens on small businesses and/or government administration?*

INFORMATION REQUEST 5.4

What examples are there of reforms that are considered 'leading practice' that should be adopted more broadly?

INFORMATION REQUEST 5.5

What are the anticipated benefits and costs of specific reforms for individual businesses, the retail industry and the community?

1 Introduction and scope

The retail industry provides a key intermediary service between producers and consumers of final goods. The sector contributes almost 5 per cent to GDP and over 10 per cent to employment.

Whether based in Australia or elsewhere, retailing is going through a major structural evolution. Various social, economic and demographic factors are affecting what consumers buy, where they buy and how much they are willing to pay. Further, the uptake of e-commerce is providing consumers with the option to search for, compare and purchase goods from around the world at their convenience. Australia is also seeing the increased entry of international retailers in the domestic bricks and mortar space. This changing playing field is intensifying competitive pressure on many retailers and compelling them to reconsider how they do business. At the same time, it is putting a stronger focus on their costs of doing business.

1.1 What the Commission has been asked to do

The Australian Government has asked the Productivity Commission to undertake a study into the cost structures of the dairy product manufacturing industry and the retail trade industry respectively as part of its broader interest in relative cost structures.

In doing so, the Commission is required to:

- undertake a case study of costs (such as those relating to capital, labour, intermediate inputs and regulatory compliance) facing the respective sectors
- where relevant, identify areas of cost advantage and disadvantage Australian businesses face relative to international competitors.

This interim report is focused exclusively on the costs of retail businesses. The cost structure of the dairy product manufacturing industry is addressed in a separate report.

The terms of reference are set out in full at the front of this report.

1.2 Scope of the study

The ABS defines a retail business as a 'unit mainly engaged in the purchase and onselling, commission-based buying, and commission-based selling of goods without significant transformation, to the general public'.

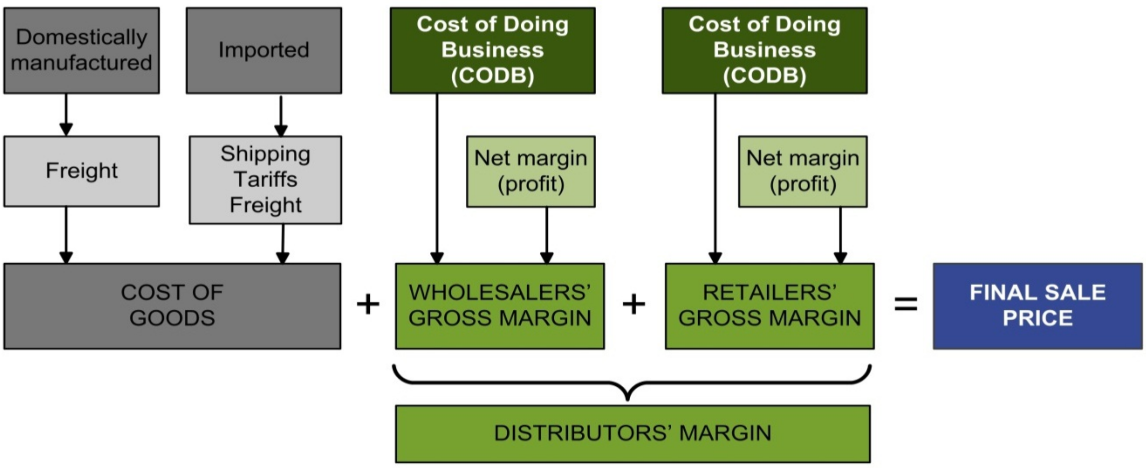
Under the Australian and New Zealand Standard Industrial Classification, the retail trade industry division (Division G) contains five industry subdivisions:

- motor vehicle and motor vehicle parts retailing
- fuel retailing
- food retailing
- other store-based retailing
- non-store retailing and retail commission-based buying and/or selling.

For businesses within these subdivisions, there are five major categories of costs incurred in getting goods to market (figure 1.1). These are:

- the cost of the goods themselves (which includes any freight to warehouses and applicable tariffs)
- the wholesaler's cost of doing business (where relevant)
- the wholesaler's net margin (where relevant)
- the retailer's cost of doing business
- the retailer's net margin.

Figure 1.1 The supply chain for retail goods



Source: D'Arcy et al. (2012).

There is a range of cost factors affecting the retail industry — some are driven by geography (such as transport costs) and market conditions (such as the cost of goods) while others are essentially determined by the decisions of individual retail businesses (for example, decisions about the use of multi-channels and pricing strategies). However, there are some cost drivers that are heavily influenced by policy and regulatory settings — some specific to the retail sector and some affecting the broader economy.

As this study is primarily designed to provide insights for considering policy options related to costs at the retail level, the Commission intends to focus on those costs of doing business at that level that are amenable to policy action by governments in Australia. While the cost of goods accounts for a significant share of final retail prices, the Commission considers that an examination of issues associated with the cost of goods is beyond the scope of this study (box 1.1).

Box 1.1 **The cost of goods**

At an aggregate level, the cost of goods as a share of total retail prices has been relatively stable over the decade to 2010, at around 50 per cent.

In the early consultations for this study some interlocutors suggested that this study should examine the cost of goods themselves. It was noted that this would allow the Commission to look at macroeconomic price pressures, and, for example, to examine the impact of exchange rate movements on domestic manufacturers and importers.

However, such an approach would effectively require examining relative costs throughout the entire supply chain for a very diverse sector, including back to the source country. It would also involve examining issues that were beyond the purview of government action in Australia. For example, wage pressures in China or government regulations in Japan could affect import prices but these are not amenable to action by governments in Australia.

1.3 The Commission's approach

The main objective of this study is to examine the cost structures facing the Australian retail industry, with a focus on both trends and levels where data are available. A secondary objective is to identify how these costs compare with those incurred by international competitors.

The paucity of published data on costs and the reticence of retail businesses to provide what is essentially commercial-in-confidence information about their costs has led the Commission to draw on a broad range of evidence in providing a picture of cost structures and their drivers. Given the diversity of the retail sector in terms of size, product range and business models, costs structures are likely to differ markedly across different retailers. Therefore, caution is needed in using aggregate industry data as representative of all retail businesses in Australia. Similarly, the lack of updated and comprehensive cross-country cost data makes it difficult to make conclusive observations about the cost differentials between Australian and international retailers. Factors such as differing business models and differing industrial relations systems also further compound comparability issues.

As part of the focus on policy relevant drivers of costs in the retail sector, this interim report also provides a brief update on the progress made by governments in implementing the recommendations from the Commission's inquiry on the economic structure and performance of the Australian retail industry (PC 2011a). In that inquiry, the Commission looked at the structure and performance of the retail industry within the context of the growing importance of online retailing. It considered other drivers of structural change in the industry including globalisation, cost structures, competition and, particularly, the regulatory landscape within which the industry operates. The inquiry report put forward a number of recommendations aimed at enhancing the performance of the industry.

1.4 Conduct of the study

The terms of reference for this study were received on 7 April 2014, and asked the Commission to provide an interim report within two months of receiving the terms of reference and a final report within six months.

The Commission advertised the study in newspapers, on its website, through Twitter and in a circular, and released an issues paper on 11 April 2014 to assist individuals and organisations to contribute to the study via public submissions.

The Commission also held discussions with individual retailers, relevant peak organisations, government agencies and industry analysts (appendix A). At the time this report was released, the Commission had received 19 written submissions (appendix A), which are available on the study's web page.

The Commission invites further public submissions to comment on the material in this interim report and to comment on issues raised by the study. The due date for such submissions is 11 July 2014. Following the release of the interim report, the Commission will hold further meetings with interested parties. The contributions of study participants and the Commission's further analysis will inform the final report, which will be provided to the Australian Government in early October 2014.

1.5 Structure of the report

A snapshot of the retail industry is provided in chapter 2. Chapter 3 examines the cost structure of the Australian retail industry and provides some limited comparative data. Some of the main policy and regulatory drivers of retail sector costs and cost differentials are outlined in chapter 4. Chapter 5 provides a progress report on the implementation of the recommendations from the Commission's inquiry on the economic structure and performance of the Australian retail industry (PC 2011a).

2 Snapshot of the industry

Key points

- In 2012-13, the retail industry contributed $68.5 billion (4.9 per cent) to Australia's value added. It employs 1.2 million people (or 10.5 per cent of total employed).
  – The retail industry is large and diverse — business size, business models, type of products sold and cost structures vary.
  – The number of businesses is around 133 000. As with most industries, there is significant entry and exit.
- Retailers are operating in an increasingly dynamic and globalised environment, competing on different sales platforms and across borders. This has undoubtedly been beneficial for consumers.
- As in other parts of the world, technological, social, economic and demographic factors are changing consumer preferences and shopping patterns.
- The increase in the household saving ratio in recent years has exacerbated pressures on retail sector margins and has increased the importance of containing costs.
- The growth of online retail and greater exposure to international competition in recent years have increased competitive pressures on retailers.
- High-profile international firms such as H&M, Zara and Costco have opened Australian stores, suggesting that the Australian retail market is internationally attractive.
- Productivity growth in the industry has been comparable or slightly better than for the market sector as a whole, notwithstanding the relatively poor overall productivity performance in Australia over the past decade.

2.1 A diverse and dynamic industry

The retail industry plays an important intermediary role

Retail trade is more than the sale of goods to consumers. In essence, it reduces the transaction costs associated with the purchase of retail goods. It caters for purchases of relatively small quantities, at times and locations that are convenient to the consumer, and enables consumers to search for, discover and learn about a wide range of goods. Further, retailers often provide an after-market service to customers who have purchased their products.

The industry is diverse …

The retail industry is diverse — business size, business models, product range and cost structures vary.

Under the Australian and New Zealand Standard Industrial Classification (ANZSIC) definition, retail trade encompasses *Motor Vehicle and Motor Vehicle Parts Retailing*; *Fuel Retailing*; *Food Retailing*; *Other Store-Based Retailing*; and *Non-Store Retailing and Retail Commission-Based Buying and/or Selling*. The bulk of the industry sits within *Other Store-Based Retailing*. However, there is a significant variety of retailers within this subdivision. It comprises: *Furniture, Floor Coverings, Houseware and Textile Goods Retailing*; *Electrical and Electronic Goods Retailing*; *Hardware, Building and Garden Supplies Retailing*; *Recreational Goods Retailing*; *Clothing, Footwear and Personal Accessory Retailing*; *Department Stores*; and *Pharmaceutical and Other Store-Based Retailing*.

The industry exhibits a range of business sizes and structures. Australian retailers range from sole-operators to businesses that are large by global standards, operate multiple retail outlets and employ a large workforce. For example, of food retailing businesses in operation at the end of 2011-12, 35 per cent were non employing, 55 per cent had a workforce of 1–19 employees, 10 per cent had 20–199 employees and about 0.5 per cent of businesses employed 200 or more people (ABS 2013b).

Australian retailers also operate in varied formats, including in shopping malls and centres, at suburban shopping strips, in large standalone warehouses and increasingly, online and across multiple channels.

… and is evolving

In parallel with global trends, the Australian retail industry is undergoing significant structural change. Retailers are operating in an increasingly dynamic and globalised environment, competing on different sales platforms and across borders — which has undoubtedly delivered better outcomes for consumers.

Technological, social, economic and demographic factors are changing what consumers buy, where and when they buy and how much they are willing to pay (box 2.1).

Technological advancements are a particularly significant driver of change within the industry. The internet, for example, allows consumers to compare prices and make better-informed purchases at a time and in a manner that suits their preferences.

> Traditionally consumers have been confronted by many obstacles when wanting to compare products to get the ‘best deal’. Historically, consumers would generally be limited to retailers in the surrounding geographic area requiring them to spend the time visiting various retailers to find out about products, specifications and negotiate best price. Modern consumer habits, expectations, and the emergence of fast improving technology have transformed the outmoded consumer shopping experience. (SPASA, sub. 5, p. 4)

Box 2.1 **Consumer preferences and expectations are changing**

Australian consumer preferences and expectations have changed due to a combination of higher incomes, changes in taste arising from social and cultural influences and technological change that has led to new products and facilitated new methods of purchasing.

In recent decades, Australia’s population has grown and its composition has changed. Female workforce participation is higher, the proportion of Australians born outside of Australia has increased, people are living for longer, there is a higher proportion of Australians aged over 65, and people are more highly educated.

There have also been economic changes over this period, including a substantial increase in real incomes. Employment patterns have also shifted — there has been an increase in the proportion of the workforce employed in the services sector and an increase in those working outside of ‘standard’ office hours.

These changes have shaped consumer preferences. Australian households have substantially increased their expenditure on services relative to goods. Expenditure on services that were previously produced within the household (such as restaurant meals, childcare and home maintenance) has increased.

Household expenditure on food has also changed. Immigration has brought new cuisines to Australia. Higher incomes have enabled consumers to spend more on food — there has been growth in spending on specialty foods and eating out.

In general, these changes mean that Australian consumers have become more diverse and more demanding, not only with respect to *what* they buy but also *when* and *how* they buy. Technological changes, such as the development of online shopping, has given consumers greater scope to shop according to their preferences. Australian consumers are indeed avid online shoppers — making Australia one of the most attractive cross-border e-commerce markets for retailers.

Sources: Borderfree (2013); Greenville et al. (2013); PC (2012a); RBA (2013); Woolworths et al. (2013).

The lines between traditional bricks and mortar and online retailers are becoming increasingly blurred as more retailers adopt an omni-channel approach to sales, utilising bricks and mortar stores and digital sales platforms, such as online and mobile channels, to engage consumers. Moreover, online retailing is increasingly exposing Australian retailers to competition from other parts of Australia and from around the world (box 2.2).

Box 2.2 **Some participants' views on online competition**

> Like any Australian retailer, Bunnings competes with international retailers, including Amazon, which requires us to be constantly vigilant to international pricing. (Bunnings, pers. comm., May 2014)
>
> … over the past decade, the retail sector has been undergoing a significant structural upheaval, following advancements in technology, digitalisation and online shopping. These changes have led to new consumer behaviours, new retailing models and increased competition through effective globalisation of retail markets. The structural shifts have brought about significant changes in the retail sector in a short period of time, with both challenges and opportunities for retailers. (NRA, sub. 18, p. 3)
>
> There is increasing pressure for Australian Large Format retailers to be cost competitive against overseas and online based competition. (LFRA, sub. 19, p. 6)
>
> … while many Australian retailers have started their own online stores … the fact remains that Australians are continuing to shop at overseas online stores in ever increasing numbers, drawn there in part because those overseas competitors continue to have an unfair price advantage over Australian retailers … (ASGA, sub. 10, p. 4)

Collection of online sales data is still developing, and a precise measure of the value of online sales in Australia is not available. ABS estimates indicate that in the 12 months to March 2014, 2.2 per cent of total Australian retail turnover was conducted online (ABS 2014e).[1] Using a more expansive definition of online retail, the National Australia Bank (NAB) estimated that over the same time period, online retail spending was equivalent to 6.6 per cent of spending at traditional bricks and mortar retailers (NAB 2014).[2]

Despite uncertainty around the quantum of online sales, it has been suggested that Australian businesses have been relatively slow to adopt online retailing, particularly compared to retailers in the United States and United Kingdom (figure 2.1) (Citi 2011; PwC 2012b).

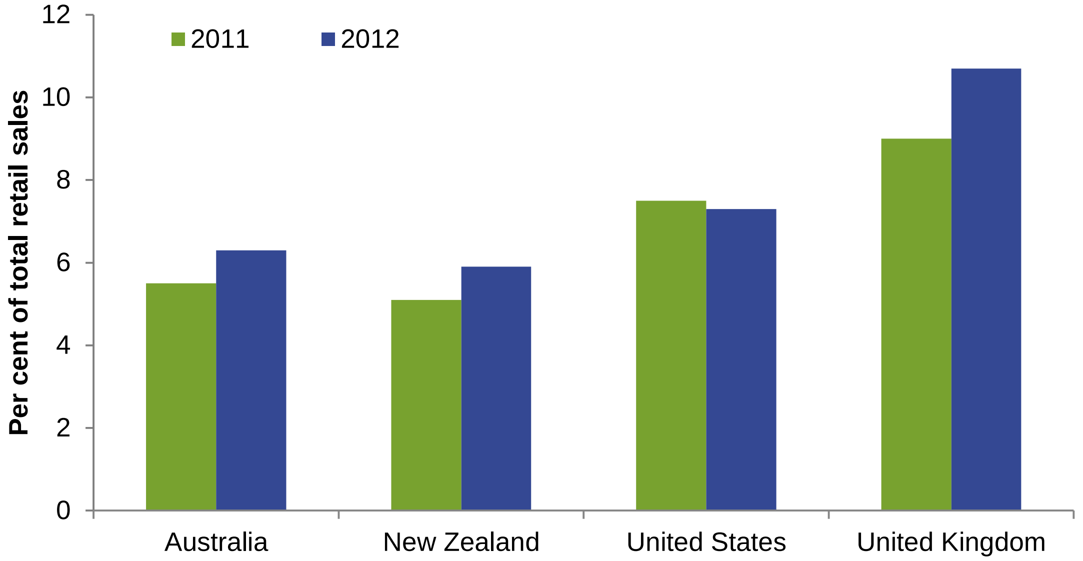
1 ABS data are for pure-play online retail trade and multi-channel online retail trade. Online sales by non-employing businesses and non-resident retailers overseas which sell directly to the Australian general public via an online store are excluded.

2 NAB employs a different methodology to the ABS. For example, it includes sales at overseas retailers, as well as sales from online music and eBook downloads.

> Despite the success of many global retailers in bolstering sales in difficult times through their online platforms, many Australian retailers continue to lag behind. … the snail-like speed of many Australian retailers to adapt to the digital age is a cause for concern. (Deloitte 2013a, p. 1)

In particular, online sales for Australia's major retailers are low compared to major retailers overseas. It is estimated that in 2011, Australian listed retailers' online sales accounted for about 1.5 per cent of total sales, while in the United States, comparable retailers had online sales of around 8–10 per cent (Citi 2011).

Figure 2.1 **Online expenditure as a percentage of total retail sales**[a]



[a] Australian and New Zealand data include purchases from overseas sites. UK and US data are only for domestic purchases.

Source: PwC (2012b).

The slow uptake of online retailing by many retailers is consistent with a historical pattern in the Australian retail sector in which uptake of innovation has been gradual (PC 2011a). However, this is in sharp contrast to Australian consumers' enthusiasm for online shopping (Borderfree 2013; PwC 2012b).

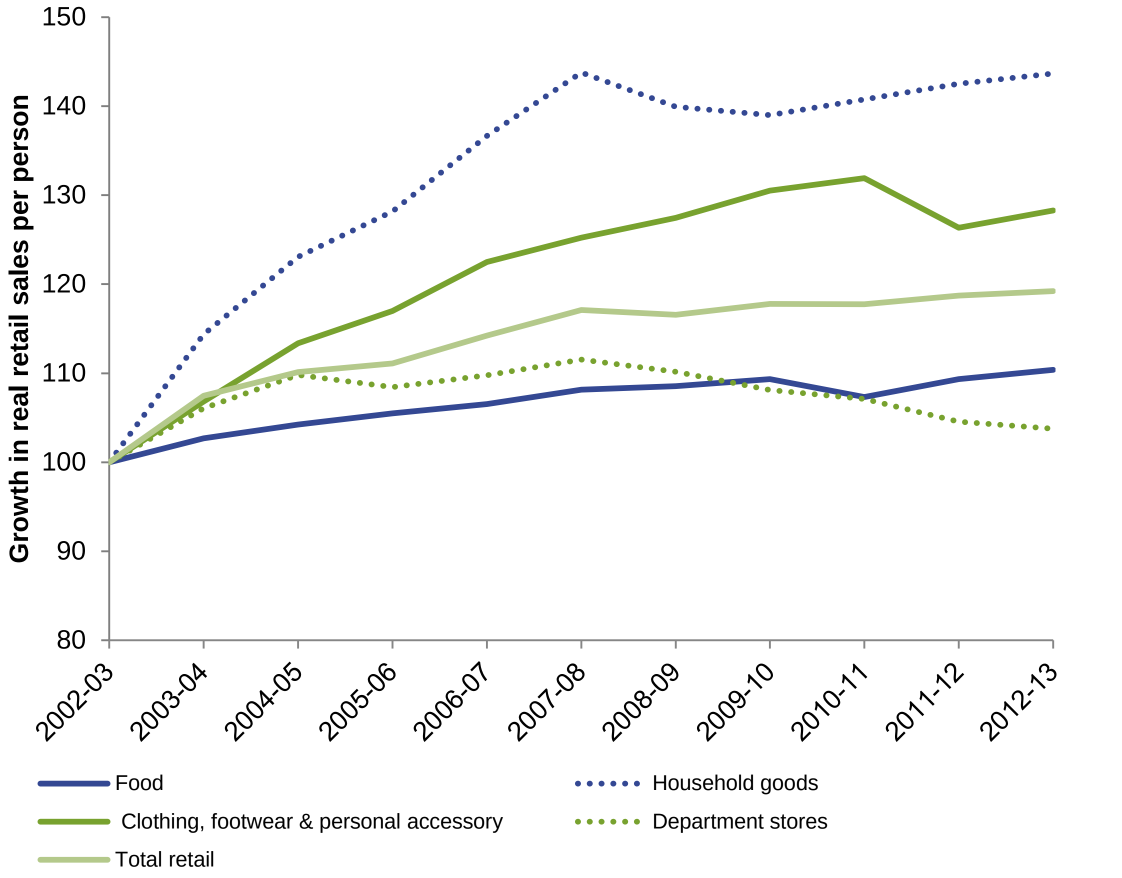
INFORMATION REQUEST 2.1

What are the impediments to a faster adoption of e-commerce by Australian retailers?

Changes in consumer behaviour are also affecting retailers (box 2.1). Consumers are saving a higher proportion of their income, spending less of their income on retail products, and are seeking greater value for money. That said, there are diverging trends in retail sales across different categories of retailing (figure 2.2).

Figure 2.2 **Growth in real retail sales per person, 2002-03 to 2012-13**[a, b]

Indexed 2002-03 = 100



[a] Per person calculation based on Estimated Resident Population. [b] Chain volume measure of seasonally adjusted retail trade turnover.

Sources: Commission estimates, ABS (2014a, 2014e).

Adding to competitive pressures for Australian retailers, international retailers are establishing a growing bricks and mortar presence in Australia. International brands such as H&M, TopShop, Zara, Daiso, and Costco have sought growth opportunities outside their local markets and have been attracted to Australia by factors such as relatively high disposable incomes and stable political and legislative arrangements (Deloitte 2013b). Their entry suggests that the Australian retail market is internationally attractive.

In recent years, prices of labour, rent and energy have risen more than the retail price index (D'Arcy, Norman and Shan 2012). As a relatively labour intensive sector, retail is particularly exposed to increases in labour costs. Chapter three considers these costs further.

Retail businesses are responding

Some retailers in Australia have been reticent to adjust to the changing retail environment. Others are adapting their businesses in order to compete for market share.

Many retailers are striving for non-price points of difference based on a combination of service, quality of goods, convenience and range. For example, supermarkets are moving into new segments — offering sushi bars, barista coffee and a larger range of take-away and convenience foods. David Jones has launched 'village format' stores which occupy a smaller retail space and provide customers with features such as digital charging stations, complimentary Wi-Fi, an interactive tweet mirror and dedicated areas to purchase and collect purchases from the David Jones online store (PwC 2013). Online retailers are creating a more realistic shopping experience for consumers — for example by introducing virtual changing rooms and offering free shipping on online purchases.

To develop these strategies and better target consumer preferences, many retailers are drawing on consumer data (KPMG 2013).

Retail businesses are also innovating and adopting a range of strategies to reduce their costs of doing business. For example, the Commission heard that one large format retailer had introduced 'shiny floors' which allow light to refract, generating savings in lighting costs for the company. Other strategies include:

- the use of new productivity-enhancing technologies such as self-assisted checkouts
- more efficient inventory management
- vertical integration of the supply chain
- growth in private-label merchandise
- bypassing wholesalers (Deloitte 2013b; PC 2011a; PwC 2012a).

2.2 Retail in the Australian economy

The industry plays a significant role in the economy

The retail industry makes a significant contribution to economic output, generating $68.5 billion or 4.9 per cent of GDP in 2012-13 (table 2.1; figure 2.3, panel a, b).

Table 2.1 **The contribution of Australian retail trade, 2012-13[a]**

		Retail trade	*Contribution to total*
			%
Gross value added	$m	68 501	4.9
Employment	millions	1.2	10.5
Wages and salaries	$m	41 159	6.2
Net capital stock	$m	64 738	1.4
Gross fixed capital formation	$m	6 167	1.4
Number of businesses	no.	133 375	6.4

a All data are for 2012-13 except for employment, which is at March 2014; and the number of businesses at end 2012-13.

Sources: ABS (2013a, 2014b, 2014c, 2014d).

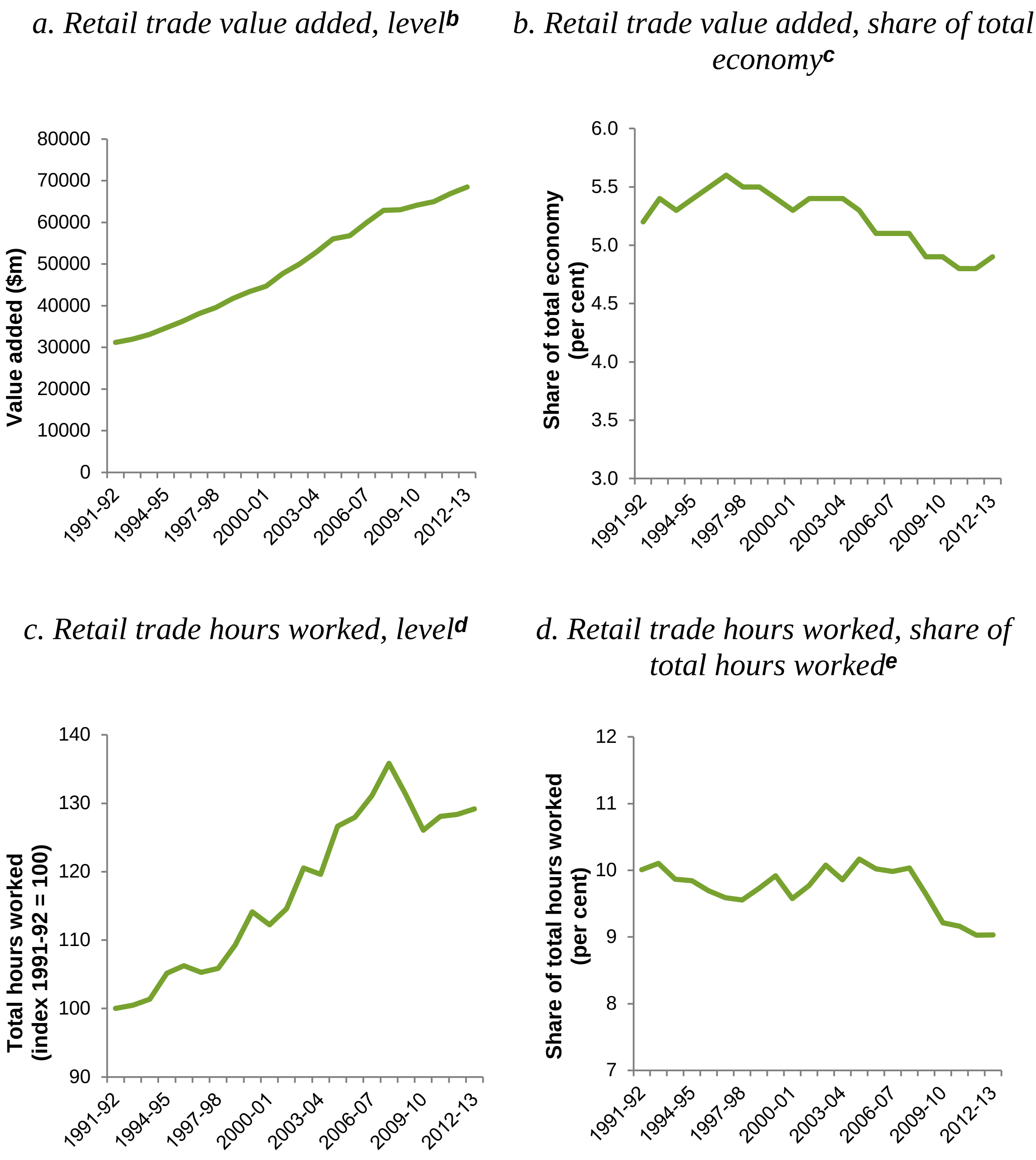
There are around 133 000 retail businesses in Australia employing just over 1.2 million people, and accounting for some 9 per cent of total hours worked (table 2.1; figure 2.3, panel d). *Other Store Based Retailing* provides the greatest contribution to retail value added and hours worked (figure 2.4).

The relative contribution of the industry to the overall economy has been declining slightly over the past decade (figure 2.3, panel b). A similar trend is evident in the number of hours worked. While the number of hours worked in retail increased between 1991-92 and 2012-13, retail's share of total hours worked declined marginally (from 10 per cent to around 9 per cent) (figure 2.3, panel c, d).

The slight decline in the relative importance of retail trade is due to a number of factors. In part, it reflects the changing structure of the Australian economy — with relatively higher growth in other parts of the economy, notably in services and the mining sector (Connolly and Lewis 2010; PC 2012a). It is also a result of changing consumer sentiment. The trend in the household saving ratio in Australia since the global financial crisis indicates that even with growing incomes, households have been unwilling to increase their rate of consumption:

> … households have spent most of the past five years behaving more conservatively … than they did over a long period up to the mid 2000s when they had been in a very expansive mood. … many businesses exposed to those sectors, including retailers, builders and banks, have found the going harder. (Stevens 2014)

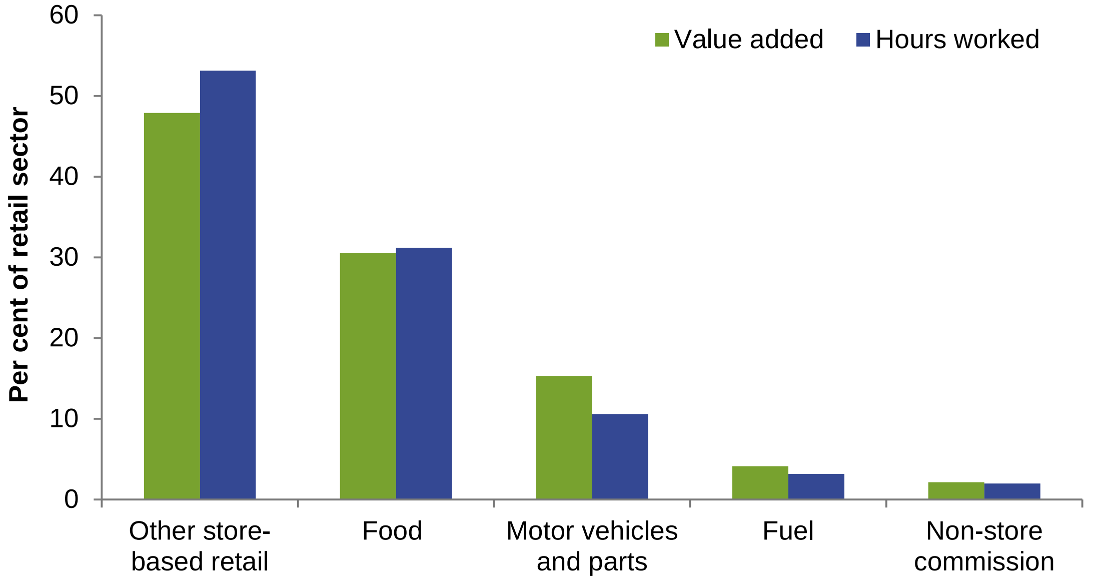
Figure 2.3 **Contribution of the retail sector[a] to gross value added and hours worked, 1991-92 to 2012-13**



a Retail trade includes motor vehicles and motor vehicles parts retailing and fuel retailing. **b** Chain volume measure of gross value added at basic prices. A basic price is the amount receivable by the producer from the purchaser for a unit of a good or service produced as output minus any tax payable, and plus any subsidy receivable on that unit as a consequence of its production or sale. **c** Percentage of gross value added, current prices. **d** Hours worked estimates for Retail trade and All industries in June 2000 quarter are not available due to questionnaire changes. The June 2000 quarter was imputed as the average of the three other quarters in 1999-00. **e** Share of total hours worked across all industries.

Sources: ABS (2013a, 2014d).

Figure 2.4 **Sub-sectoral contributions to total retail value added and total retail hours worked, 2012-13[a, b]**



a Percentages may not add to 100 due to rounding. **b** ABS estimates of hours worked by retail sub-sector include an 'other' category. This category has been excluded from the denominator in percentage calculations.

Sources: ABS (2014b, 2014d).

Further, households are spending a smaller share of their consumption expenditure[3] on retail goods, electing instead to purchase more services provided by other industries (Beech et al. 2014).

There is continuous entry and exit

As with most industries, there is significant entry and exit. From 2009-10 to 2012-13, the exit rate has been around 15 per cent each year, while the entry rate has fallen from about 17 per cent in 2009-10 to about 9 per cent in 2012-13. Of those retail businesses operating in June 2009, 41 per cent had exited the industry by June 2013 (ABS 2014c).

3 Household final consumption expenditure includes payments on retailer supplied goods, as well as payments on services supplied by other industry sectors such as health, education, electricity, hospitality and accommodation and food services.

2.3 Indicators of retail performance

Performance of retail businesses varies

There has been a slowdown in total retail sales growth since 2008-09. From 2008-09 to 2012-13, average growth in retail trade turnover was about 2.2 per cent per year. This compares with a growth rate of about 4.8 per cent per year from 2002-03 to 2007-08. Household goods retailing had the strongest sales growth in the industry from 2008-09 to 2012-13 (as well as from 2002-03 to 2012-13) while sales growth was negligible in department stores.[4]

The competitiveness of retail businesses, and hence their performance, is related to a range of factors, such as market conditions, size of business, business structures, marketing strategies, and cost structures. Performance indicators for the retail industry (table 2.2) illustrate the diversity in performance across sub-sectors. For example, in 2011-12 retail profit margins averaged 5.6 per cent, but ranged from 5.9 per cent in *Other Store-Based Retailing* to 9.0 per cent in *Non-Store Retailing and Retail Commission-Based Buying and/or Selling*.[5]

Table 2.2 **Performance indicators for the retail industry 2012-13**
Selected retail sub-sectors and total retail industry

		Food	*Other store-based*	*Non-store and commission-based*	*Total retail*[a]
Operating profit before tax	$m	6 615	8 920	615	21 126
Average profit per business[b]	$'000	259.5	105.1	44.4	152.8
Change in operating profit before tax	%	0.2	0.8	1.3	8.6
Profit margin	%	6.0	5.9	9.0	5.6
Industry value added per person employed	$'000	51.5	48.4	51.6	54.9
Businesses that made a loss	%	23.2	28.2	29.1	26.8

[a] Total retail includes motor vehicles and motor vehicle parts and fuel retaining. [b] Average profit per business is estimated as operating profit before tax divided by the number of businesses in each sub-sector. However data on the number of businesses per sub-sector in 2012-13 is not available. The proportion of businesses in each sub-sector relative to total retail trade in 2011-12 and the total number of retail businesses in 2012-13 were used to estimate an approximate number of businesses per sub-sector in 2012-13. [c] Profit margin is the percentage of sales and service income available as operating profit before tax.

Source: ABS (2014b).

4 ABS value of turnover estimates for retail trade include cafes, restaurants and takeaway food services even though these are not included in ANZSIC Division G, Retail trade.

5 Profit margins were lower in *Motor Vehicle and Motor Vehicle Parts Retailing* and *Fuel Retailing*, contributing to a lower profit margin for total retail trade.

Net retail margins — or profits — have remained relatively stable over the past two decades, despite the pressures that have emerged in the retail industry (chapter 3).

Retail sector labour productivity is broadly comparable to productivity in the market sector …

Productivity measures how efficiently inputs, such as capital and labour, are used to produce outputs in the economy. Productivity growth indicates businesses have reduced their costs relative to their output.

Labour productivity measures efficiency in the use of labour, and it also captures the value added from growth in capital that supports increased output without increasing labour. Labour productivity growth in retail trade from 1993-94 to 2012-13 has been comparable to that of the 12-industry market sector (2.5 per cent in retail compared to 2.4 per cent in the 12-industry market sector) (table 2.3).

… and although retail multifactor productivity growth has slowed, it is strong relative to the market sector as a whole

Much of the historical growth in retail labour productivity can be attributed to multifactor productivity (MFP)[6] growth, which has averaged 1.6 per cent per year since 1993-94 (table 2.3).

Table 2.3 **Productivity growth in retail trade and the 12-industry market sector**[a]

Average annual growth rate (per cent) in labour productivity (LP), multifactor productivity (MFP) and capital deepening

	Retail trade			*12-industry market sector*		
	LP growth	*MFP growth*	*Capital deepening*	*LP growth*	*MFP growth*	*Capital deepening*
1993-94 to 1998-99	2.9	2.0	0.9	3.7	2.5	1.2
1998-99 to 2003-04	3.0	2.1	0.9	2.5	1.1	1.3
2003-04 to 2007-08	1.4	0.4	1.0	1.5	-0.1	1.6
Incomplete cycle: 2007-08 to 2012-13	2.7	1.8	0.9	1.9	-0.6	2.5
Full period: 1993-94 to 2012-13	2.5	1.6	0.9	2.4	0.8	1.6

a LP growth is equal to MFP growth plus capital deepening. Differences may occur due to rounding errors.

Source: Estimates based on ABS (2013c).

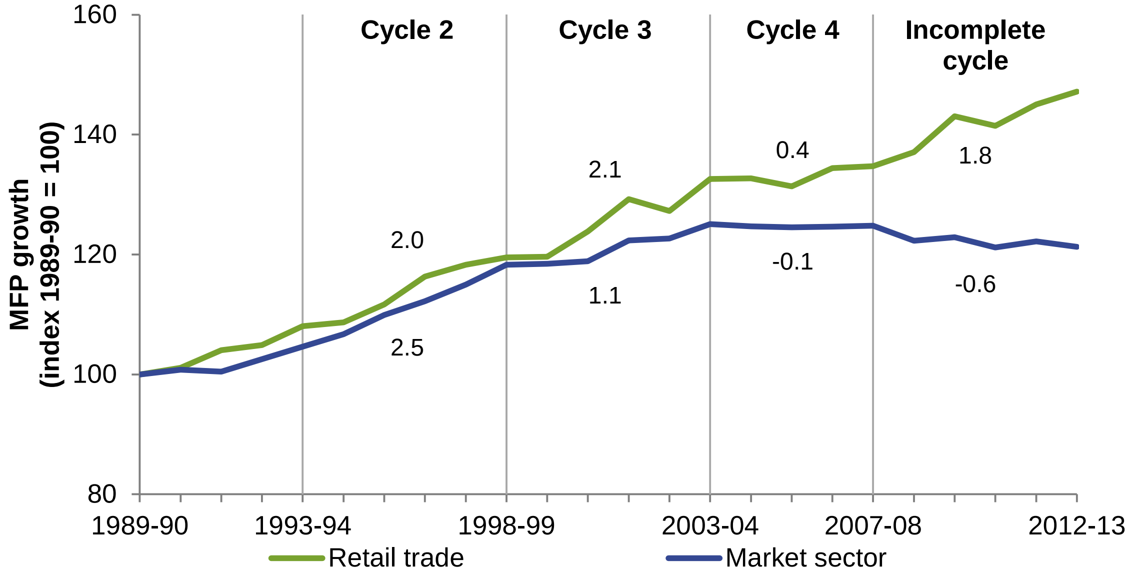
6 Growth in MFP measures the growth in output produced per combined inputs of labour and capital.

The growth in retail trade MFP has slightly weakened since 1993-94 (table 2.3). Despite this, retail trade MFP growth has been higher than the 12-industry market sector for most periods since 1993-94 (figure 2.5) and has, on average been double the growth rate of the market sector as a whole. More broadly, while Australia's long term (1973-74 to 2012-13) market sector MFP growth was 0.7 per cent per year, over the past decade market sector MFP growth has noticeably deteriorated (PC 2014).

Capital deepening in retail trade (an increase in the capital–labour ratio weighted by the share of capital) has remained relatively constant over the ABS defined productivity cycles.

Figure 2.5 **MFP in retail trade and the 12-industry market sector, by cycle**[a]

Index 1989-90 = 100



[a] Retail trade includes motor vehicles and motor vehicles parts retailing and fuel retailing.

Source: Commission estimates based on ABS (2013c).

Many of the productivity improvements that enable retail businesses to lower their relative costs are driven by internal changes, such as adoption of new technologies and greater supply chain efficiencies. However, some costs are also affected by government policy and regulatory settings, which may restrict retailers' abilities to pursue productivity gains. The remainder of this interim report will outline retailers' costs of doing business and potential policy and regulatory drivers of these costs.

3 Relative cost structures

Key points

- There is a diversity of business cost structures across different types of retail businesses and between competitors. This reflects a range of factors, including different business strategies. Many aspects of business costs are either driven by market conditions or by decisions made by businesses themselves. Only some cost drivers are amenable to policy intervention.
- A priori, there is little reason to suspect one form of cost structure is superior to another. Cost structures themselves do not indicate where policy reform might be needed. At best they are informative of the potential scale of impacts of policy changes.
- Retail net margins have been relatively stable over time, though there have been some increases in the last two years, following a slump in 2007-08.
- The Australian retail industry is relatively labour intensive. Labour input prices have increased in real terms for the retail industry. However, employment has continued to increase notwithstanding a short term decline post 2007-08.
- Other major areas of expense for retailers in Australia include occupancy and rent, and professional services. There is some evidence to suggest that non-labour input prices have increased faster than retail prices over the past decade.
- On the basis of limited available data, there are no discernible differences in cost structures between Australian retailers and those operating in broadly comparable markets overseas for some retail categories. However, for other retail categories, such as clothing, Australian retailers have relatively high cost shares for labour and rent.
- Prima facie, labour unit costs appear to be relatively high in Australia by international standards. Similarly, occupancy costs, as a share of sales, seem to be relatively high in Australia.

The Commission has been asked to examine the costs facing businesses operating in the Australian retail industry, with a focus on cost issues that are relevant to policy. This chapter first considers the cost structures of the retail trade sector according to the best available data (section 3.1). Understanding the cost structures of retail businesses operating in Australia is useful in considering the potential impacts of policy, and provides a context for discussion. Comparisons between Australian and international cost data can be of some use in highlighting any unique features of the domestic retail industry, as well as the trends that are common across countries (section 3.2).

3.1 Retail cost structures

Prices of retail goods are made up of the costs of goods sold; the gross wholesale margin; and the gross retail margin (figure 3.1, left panel). In turn, the gross retail margin is comprised of the net retail margin (or profit) and the costs of doing business — the latter being the focus of this study (figure 3.1, right panel).

The Reserve Bank of Australia (2014) noted that gross retail margins had grown in line with final retail prices between 2003 and 2011, growing marginally faster between 2011 and 2013. The growth in gross margins was evident in both aggregate industry data[7] and from a sample of 21 listed retailers.

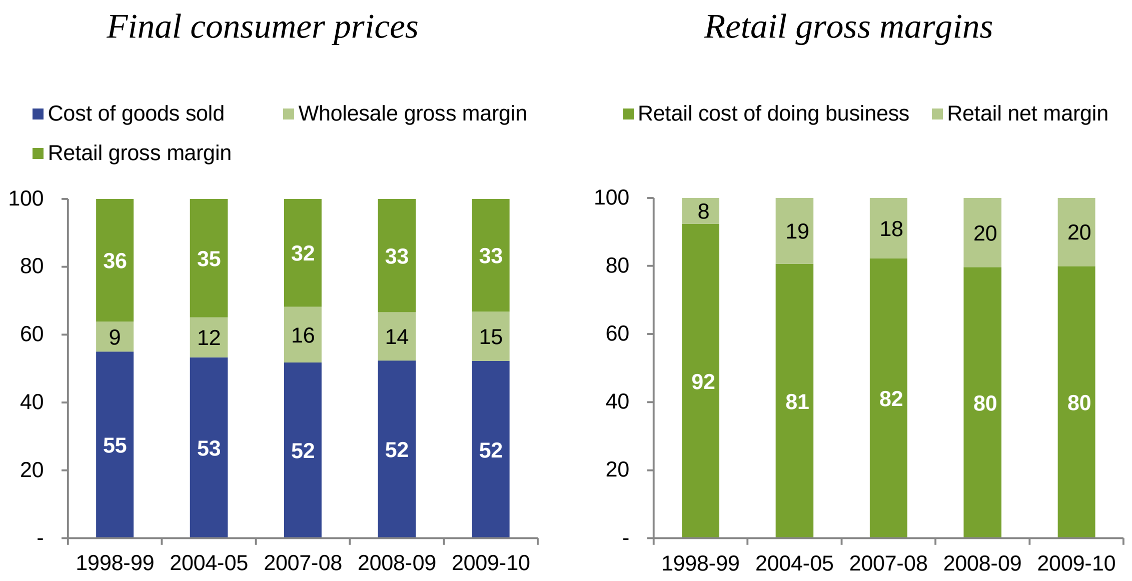
It is difficult to determine what is driving the growth in gross retail margins, or what the interplay has been between costs and net margins. Many stakeholders have pointed to rising costs of doing business throughout the past decade (box 3.1). Net margins have been relatively stable in the longer term, though there have been some increases in the past two years, following a slump in 2007-08 (figure 3.2). It is difficult to paint a more updated picture of the relative growth in costs and net margins with data from input-output tables as they are only available for up to 2009-10 (figure 3.1, right panel).

While many stakeholders have commented on the rising costs of doing business in Australia, the experiences and perspectives of individual businesses vary — as in any industry, business profitability varies and some firms are unprofitable (table 2.2). In the face of rising costs, businesses may take measures to reduce costs, reduce their profit margins, allow prices to rise; or, more likely, some combination of these measures. As noted by D’Arcy et al. (2012), to the extent that retailers have found efficiency gains, this may have put downward pressure on the otherwise rising costs of doing business.

7 The ABS Experimental Producer Price Index for the Output of the Retail Trade Industry (RTPI).

Figure 3.1 **Retail costs of doing business and net margins are a significant part of final prices, 1998–99 to 2009–10[a]**

Percentage breakdown of final consumer prices (left panel); percentage breakdown of retail gross margins (right panel)

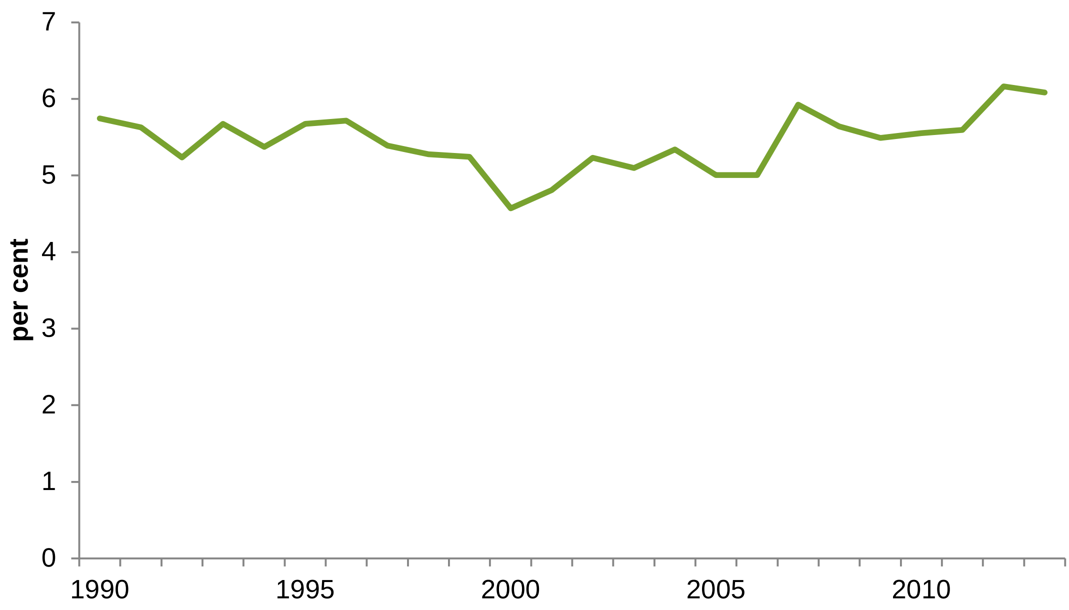


[a] Based on household expenditure on domestic and imported manufactured goods, retail trade and wholesale.

Data source: ABS (*Australian National Accounts: Input-Output Tables*, Cat no. 5209.0.55.001).

Figure 3.2 **Net retail margins have been relatively stable**

Gross operating surplus as a proportion of sales income, 1990–2013



Data sources: Commission estimates based on D'Arcy et al. (2012) and ABS (*Australian National Accounts*, Cat. no. 5204.0; *Business Indicators, Australia, March 2012*, Cat. no. 5676.0).

Box 3.1 Retailers have noted rising costs

Several stakeholders have made reference to high or rising costs of doing business in Australia. For example, Frontline Hobbies (sub. 4, p. 1) noted that:

> The costs involved doing business in the retail trade within Australia today are on an upward spiral which results in diminished profits, reduction in the workforce and rampant apprehension about the future.
>
> Costs relating to labour, energy, taxation, superannuation, tenancy and regulatory compliance increase every year, yet gross profit margins cannot keep pace.

The Australian Sporting Goods Association (sub. 10, p. 9) stated:

> Australia is generally considered an expensive country in which to conduct a retail business, but is nevertheless considered a good place to do business, due to our high standard of living and stability.

Sources: Frontline Hobbies (sub. 4); Australian Sporting Goods Association (sub. 10).

Industrywide costs of doing business

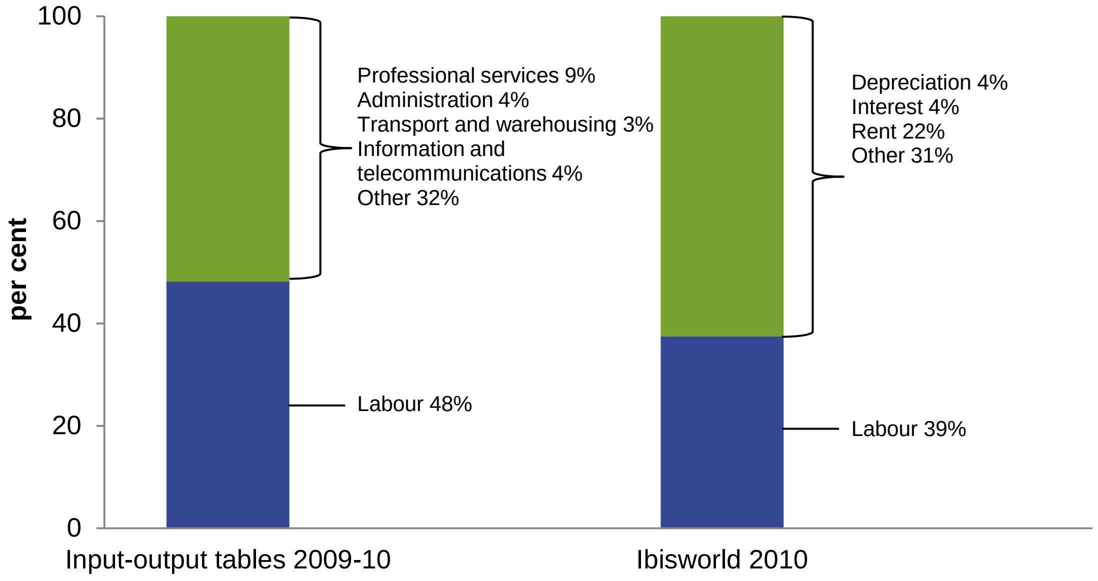
The cost of doing business is comprised of several areas of expense. In aggregate statistics, these are often broken down into:

- *labour costs* — wages paid to directly employed retail workers (such as customer service staff, managers, and delivery workers)
- *the costs of physical capital* — equipment and other capital used in retail (such as buildings, equipment and communications technology)
- *intermediate inputs* — the costs of materials and services from other sectors (such as accounting and insurance services).

The overall cost structure of the retail industry can be estimated using various data sources, though the results are likely to differ somewhat (figure 3.3). For instance, input-output tables from the ABS give a relatively transparent breakdown of labour and intermediate inputs, though the tables form a relatively complex system of national accounts (left panel). Estimates from private analysts such as Ibisworld (right panel) are also useful, although estimates are based on a range of sources including data from the ABS, the Australian Tax Office (ATO), and individual firms. The differences between estimates reflect differences in data sources, methodology and definitions. What is clear from all of these estimates, however, is that labour costs tend to be the single largest area of expense for retail businesses.

Figure 3.3 **Labour costs account for a major portion of the costs of doing business**[a]

Breakdown of gross retail margin from input–output tables 2009-10 (left panel)[b]; Breakdown of gross retail margin from Ibisworld 2010 (right panel)



a Based on household expenditure on domestic and imported retail trade. Excludes tax expenses. **b** The input categories from input-output tables have been shortened for the chart. In full, they are Cost of Employees; Rental, Hiring and Real Estate Services; Professional, Scientific and Technical Services; Administrative and Support Services; Transport, Postal and Warehousing; Information, Media and Telecommunications.

Data sources: ABS (*Australian National Accounts: Input-Output Tables*, Cat no. 5209.0); AFR (2010).

Retail trade tends to be labour intensive — while capital accounts for around 32 per cent of retail's combined capital and labour costs, the average for all industries is 46 per cent.[8] The main areas of capital investment for retail businesses are in machinery and equipment, as well as non-dwelling construction.[9]

Intermediate inputs to the retail sector are diverse. Some of the main intermediate goods and services purchased by the retail sector include manufactured inputs[10]; professional and administrative services; occupancy services; and communications technology. The actual inputs will differ from business to business, and may be better deconstructed at the sector or business level.

8 ABS (Australian System of National Accounts, Cat. no. 5204.0, table 46).

9 According to ABS National Accounts, in 2012–13, gross capital formation in the retail trade sector consisted of machinery and equipment (56 per cent); non–dwelling construction (29 per cent); computer software (13 per cent); and research and development (2 per cent).

10 These are separate to manufactured goods to be sold, however they may include inputs to goods for sale. For instance, if a retail business were to buy meat products and process them into a separate food product before sale, then the meat would be an input, even though it is eventually a part of the final product for sale.

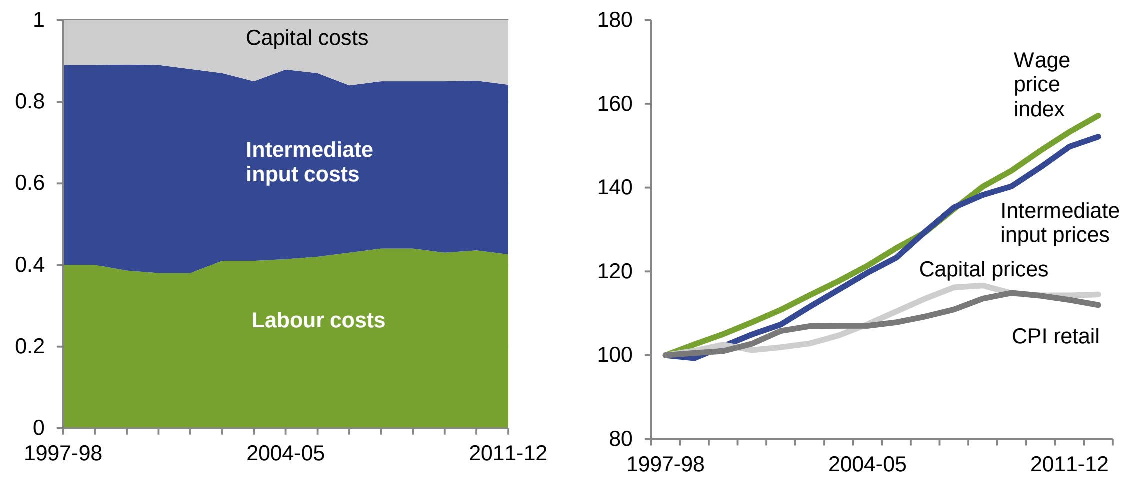
While there have been small fluctuations in the cost shares of labour, capital and intermediate inputs, the cost structure of retail trade has not changed fundamentally in the past ten years (figure 3.4, left panel), with labour and intermediate inputs continuing to comprise the majority of the costs of doing business.

Over the same period, prices of labour and intermediate inputs have risen faster than retail prices (figure 3.4, right panel). This is consistent with other data from the ABS which suggest that prices of inputs such as electricity, non-residential property, and warehousing and storage have risen faster than retail prices (figure 3.5).

Figure 3.4 **Labour and intermediate input prices have increased relative to capital prices and final retail prices**

Labour, intermediate input and capital cost shares

Retail input price indexes and the Consumer Price Index, 1997-98 = 100[b]

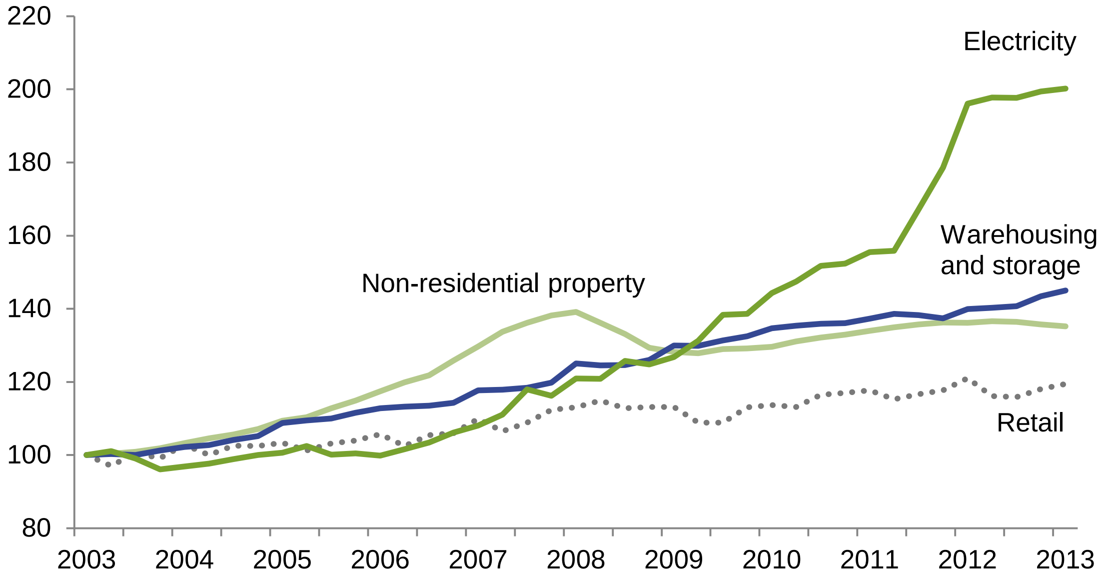


[a] According to National Accounts 2012-13, compensation of employees data have been revised up in reference years 2001-02, 2004-05 and 2005-06 by around $3–4 billion which affects the relative shares of intermediate inputs and costs of employees, which declines and improves by around 2 per cent respectively. Income revisions in Australian National Accounts in 2008-09 and 2010-11 appear to have had some impact in the relative income shares in 2006-07 and 2008-09 input-output tables respectively. [b] Prices for intermediate inputs, labour and capital are calculated specifically for the retail trade sector. The Consumer Price Index (CPI) used is similar to that used by D'Arcy et al. (2012), which excludes non-retail goods and services so as to better reflect final retail prices. It includes food & non-alcoholic beverages (excluding fruit and vegetables and meals out and takeaway foods), alcoholic beverages, clothing and footwear (less cleaning, repair and hire of clothing and footwear), furnishings, household equipment and services (less domestic and household services), motor vehicles, spare parts and accessories for motor vehicles, audio, visual and computing equipment and services, newspapers, books and stationary, equipment for sports, camping and recreation and games toys and hobbies.

Data sources: Commission estimates based on ABS (*Estimates of Industry Multifactor Productivity, 2011-12*, Cat. no. 5260.0; *Australia System of National Accounts*, 2012-13, Cat. no. 5204.0); D'Arcy et al. (2012).

Figure 3.5 **Output prices of utilities and property industries have grown faster than for retail trade[a]**

Producer Price Indexes for Retail Trade, Non-Residential Property Operators; and Warehousing and Storage; Indexes 100 = December, 2003



[a] Electricity prices are proxied by an index of those electricity prices faced by the manufacturing sector. Price indexes are based on the outputs of those industries, and are not limited to the goods and services that are used as inputs in the retail industry.

Data source: ABS (*Producer Price Indexes, Australia, 2014*, Cat. no. 6427.0).

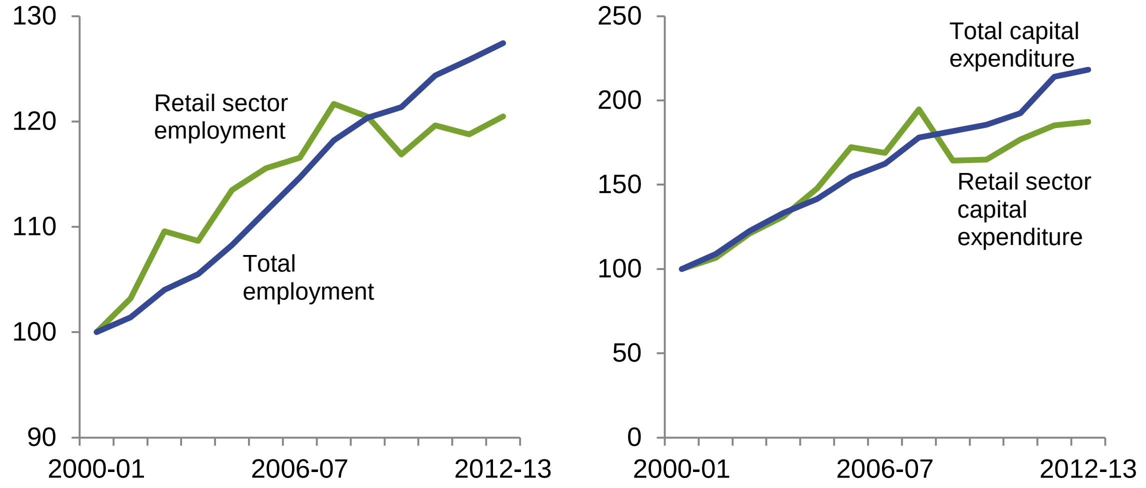
The number of employees in retail trade has grown over the past ten years, notwithstanding a significant slump after 2007-08 (figure 3.6, left panel). A similar trend is evident in the number of working hours in retail trade.[11] Capital investment in retail trade also experienced a slump in 2007-08, but overall, has grown in the past decade (figure 3.6, right panel).

Anecdotally, the Commission understands that different retailers are taking different approaches to respond to competitive pressures. This generally involves some combination of passing costs on to customers, reducing net margins; pushing costs onto suppliers and wholesalers; or implementing other cost saving measures. The combination of measures taken by any particular business will reflect their market power and exposure to competition.

11 While retail trade employed around 1691 million working hours in 2002–03, this rose to a peak of 1906 million hours in 2007–08. After two years in decline, retail trade working hours grew to 1812 million hours in 2012–13 (ABS 2014b).

Figure 3.6 **Capital expenditure and employment are close to pre-GFC levels[a]**

Index based on total employed persons, 100 = 2000-01 (left panel); Index based on gross fixed capital consumption 100 = 2000-01 (right panel)



[a] The index of employment is based on the total number of people employed, and includes both part time and full time workers. Capital expenditure is measured as gross fixed capital formation, using chain volume measures.

Data sources: ABS (*Australia System of National Accounts*, 2012-13, Cat. no. 5204.0; *Labour Force, Australia, Detailed, Quarterly*, Cat. no. 6291.5.55.003).

Diversity in retail business cost structures and in their reporting

Detailed cost structures are regularly published by retailers that are publicly listed companies. While these companies are compelled to provide financial statements in accordance with accounting standards, they are not required to report detailed cost breakdowns. As a result, the cost structures found in annual reports are only partially comparable.

Cost structures of smaller businesses are likely to be different to those of listed companies, and published information on smaller businesses is limited. The Commission has received some partial information on smaller retailers through the public submissions to this study, including Gilmour's (sub. 11) and the WA Independent Grocer's Association (sub. 2). A larger sample would be needed to allow a meaningful comparison of costs across different types of retail businesses.

The available evidence suggests that cost structures vary across types of retail trade (figure 3.7), and between individual retailers (figure 3.8). The available evidence suggests that for most retailers, labour and occupancy costs comprise a major share of the costs of doing business.

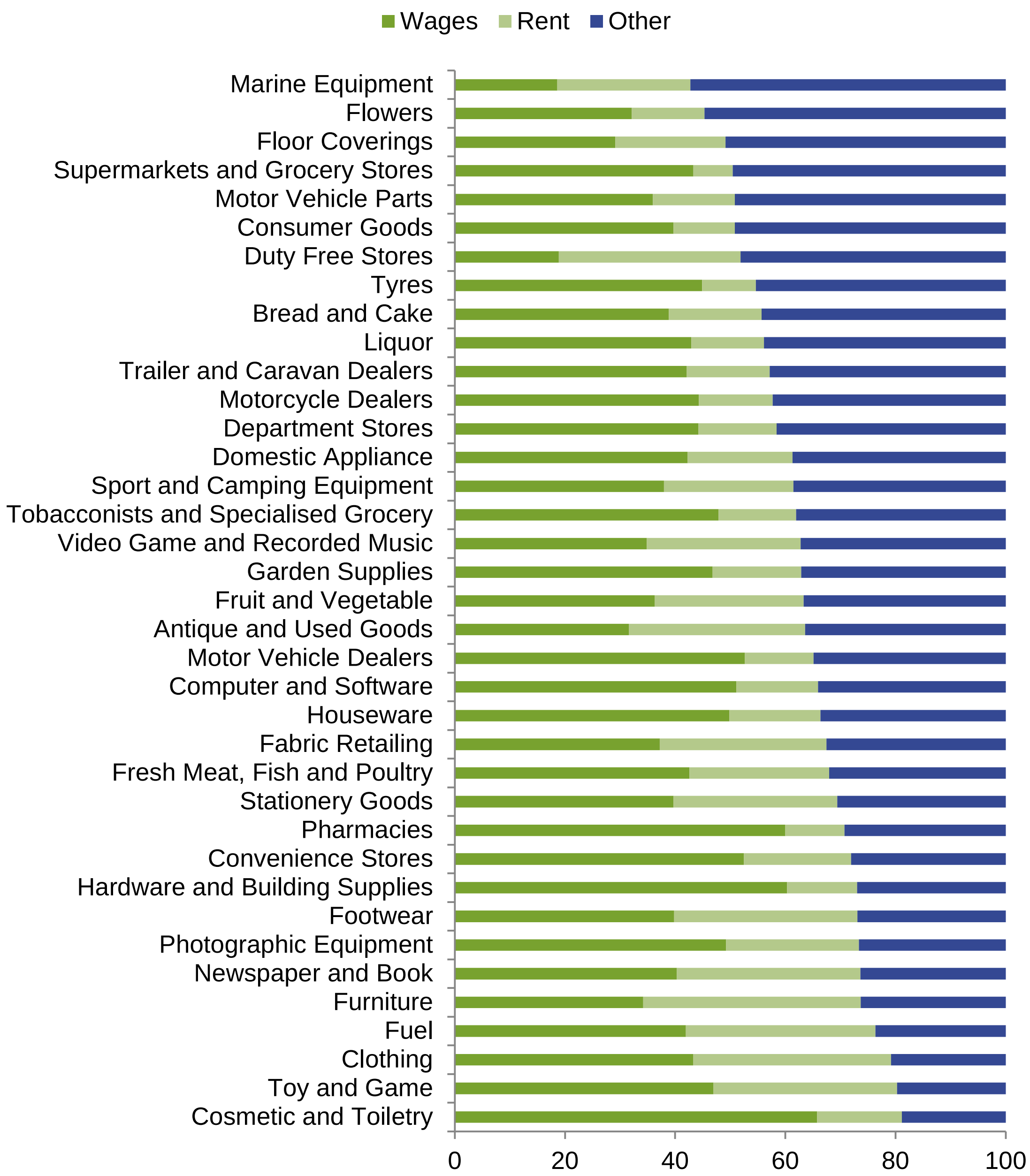
The different cost structures observed are the result of a number of decisions made by firms, reflecting the overall business models they consider most appropriate for their business environment. For instance, some retailers may attempt to minimise their labour costs by paying the minimum wage, while others compete for higher quality staff by paying above-Award rates. Cost structures are also tempered by issues that cannot be controlled by retail businesses (such as differences in compliance costs or input prices).

Evidence of raw differences in cost structures would not in itself indicate whether a business model is good or bad, nor would it imply the need for policy intervention. Cost structures can only give some indication of the scale of regulatory or policy impacts on business costs. Reform should focus on barriers and burdens resulting from inefficient regulation or from market failures.[12]

[12] The term market failure refers to situations where market mechanisms fail to deliver an efficient outcome. Inefficient outcomes can include poor allocation of resources; overproduction of negative externalities; or the underproduction of positive externalities. Market failure does not refer to the failure of individual businesses.

Figure 3.7 **Employee and occupancy expenses comprise a significant share of the costs of doing business across retail subdivisions**

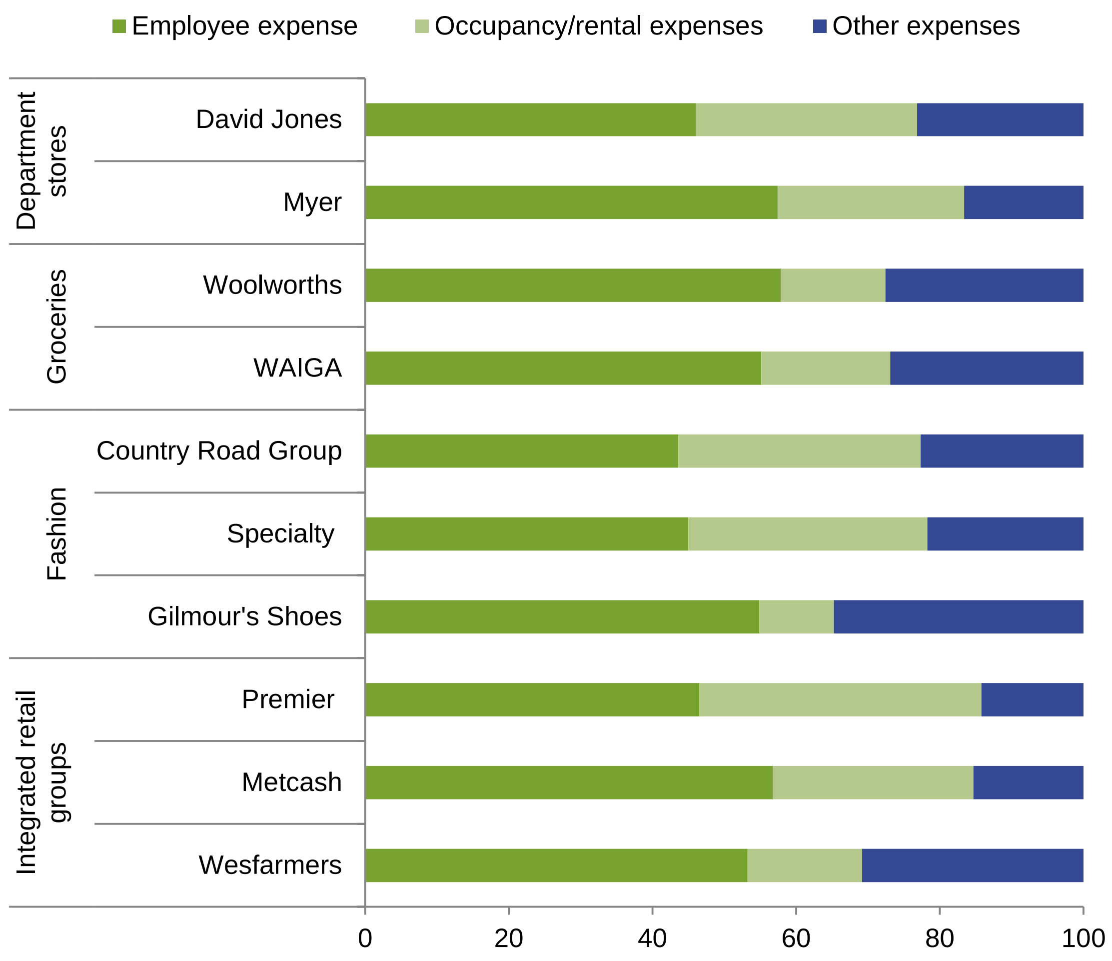
Selected expenses as a percentage of the cost of doing business



Data source: Ibisworld unpublished data.

Figure 3.8 **The share of the costs of doing business comprised of employee and occupancy costs differs across retailers 2012–13[a]**

Selected expenses as a percentage of the cost of doing business



[a] WAIGA refers to the Western Australian Independent Grocers Association. The WAIGA provided a range of percentages covering their diverse membership, while the figure presents the median percentages of those ranges. 'Integrated retail groups' are comprised of a diverse set of retail businesses, and may also own wholesale businesses, though the term is only indicative — large companies such as Woolworths are also somewhat diverse. Other expenses do not include costs of goods sold, changes in inventory of finished goods or foreign exchange losses.

Data sources: WA Independent Grocers Association, sub. 2; Gilmour's, sub. 11; various annual reports FY2013.

Online and multi-channel formats can affect cost structures

Cost structures in retail trade are likely to be affected by the growth of Australian online retailing and by the moves of existing retail firms towards multichannel retailing. Expenses on rent, occupancy, and potentially labour are likely to be lower for online retailing compared to traditional stores, while delivery costs are likely to be higher. Citi (2011) suggests that as a percentage of sales, the costs of doing business are likely to be lower in an online store than in bricks-and-mortar shops, though this cost advantage is observed for clothing and department stores and not in grocery and electronics retailing.

The effect of the increasing online presence may be complex, and should be tested empirically. While a multichannel retailer can be expected to have lower average costs of doing business than a traditional retailer, profitability will still depend on whether firms will compete on prices with the prevailing online businesses, or whether they will be able to charge similar retail prices as in their traditional stores (Citi 2011, p. 15).

Significant areas of cost

Labour costs include wages and other on-costs

The evidence is fairly consistent in suggesting that labour expenses are the single largest expense for retail businesses. Wages and salaries comprise only one part of the staffing costs for retail businesses. Other direct outlays include employer contributions to superannuation; workers' compensation; as well as fringe benefits and payroll taxes (table 3.1).

While wages comprise the majority of labour costs across all types of retail businesses, the relative importance of 'other labour costs' is higher for food retailers than for the 'other store based' category of retailers, which includes the majority of non-food retailing.[13] The differences observed across subdivisions reflect several factors, including the number of employees required for each type of retailing; differences in skill and expertise required; management structures; and the extent to which firms compete for labour through higher wages.

Costs attributed to wages and salaries are determined by rates of pay (decided by market forces and/or the Awards system) as well as the type and amount of labour used. The latter would reflect business decisions, which would be constrained by such factors as the availability of appropriate labour in the marketplace, the potential for technology to partly substitute for labour, the type of retail trade involved, and the regulatory framework.

[13] Other store based retailing (ANZSIC subdivision 42) includes Furniture, Floor Coverings, Houseware and Textile Goods Retailing (Group 421); Electrical and Electronic Goods Retailing (Group 422); Hardware, Building and Garden Supplies Retailing (Group 424); Clothing, Footwear and Personal Accessory Retailing (Group 425); Department Stores (Group 426); Pharmaceutical and Other Store-Based Retailing (Group 427).

Other labour costs aside from wages and superannuation may be affected by a diverse set of policy issues. As noted in the Commission's 2011 report into the retail sector, other issues that present significant staffing costs to retailers include those relating to leave and working conditions. Furthermore, many important labour issues may not relate directly to costs, such as hiring and rostering practices, or the efficiency of bargaining arrangements.

Table 3.1 **Wages account for the bulk of labour costs**

$ million, 2011-12

	Wages and salary	*Employer superannuation contributions*	*Other labour costs*[a]	*Total labour costs*
Motor vehicle and parts	5 367	468	368	6 203
Fuel	1 246	102	61	1 410
Food	11 083	923	931	12 937
Other store-based	20 803	1 892	1 033	23 728
Non-store and commission	602	59[b]	24	686
Total retail trade[c]	39 102	3 445	2 418	44 965
Total selected industries[d]	473 896	41 658	28 220	543 774

[a] Other labour costs includes workers' compensation costs, fringe benefits tax and payroll tax. [b] The Non-store and commission employer superannuation contributions estimate has an associated relative standard error between 10 and 25 per cent. [c] Retail trade includes motor vehicles and motor vehicles parts retailing and fuel retailing. [d] Total selected industries excludes Financial and insurance services.

Source: ABS (*Australian Industry*, 2011-12, Cat. no. 8155.0).

Changes in occupancy costs are more significant for smaller retailers

For retailers, occupancy costs include those costs associated with maintaining a shop space. Occupancy costs generally include rent and other fees paid to landlords for shared services and facilities such as security, air conditioning, lighting, marketing, and the operation of car parks. Some larger retailers may, at times, own their land and buildings or rent it from a related company (Colliers International 2013). Such retailers will still pay occupancy costs which would include all of those costs associated with owning and managing these shop spaces.

It is clear that occupancy costs are often major expenses for many retailers, and the significance of these expenses varies between different types of retail trade (figure 3.9; table 3.2). As a percentage of sales, supermarkets pay proportionally little rent compared to smaller specialty stores (table 3.2). More generally, many larger stores, which are more likely to operate in low-rent environments as opposed to prime real estate, do not consider rent and occupancy costs as major issues (Large Format Retail Association, sub. 19, p. 7).

Table 3.2 **Occupancy and rent expenses differ between retail businesses**
Per cent

Business	*Occupancy/ rent as a proportion of costs of doing business*	*Occupancy/ rent as a proportion of sales*
David Jones	31	4.5
Wesfarmers	16	4.1
Specialty Fashion Group	33	19.5
Premier Investment Group	39	21.2
Country Road Group	34	18.4
Harvey Norman	23	21.6
JB HiFi	26	4.2
WA Independent Grocers Association	19	NA

Sources: WA Independent Grocers Association, sub. 2; various annual reports 2012-13.

Several factors may determine how much a retail business will pay in occupancy costs. The ratio of occupancy costs to retail turnover varies according to location type (figure 3.10). The highest ratios are observed for central business district (CBD) and regional centres. It should be noted that such ratios are not only sensitive to changes in rents, but also in retail sales. The findings are generally consistent with the Commission's (2008) report into retail tenancy, which observed that costs per square metre were lower outside of shopping centres and 'prime retail strips'. Retail rents differ between location types due to factors such as local land and property prices; retail profitability; and relative bargaining power.

Some stakeholders have suggested that rents have been relatively stable in recent years (Large Format Retail Association, sub. 19). Colliers International (2012, p. 3) notes that in the decade to 2012, ratios of retailers' rent costs to turnover had been largely stable. Further investigation is needed to clarify how these observed trends in aggregate rents may translate to particular regions or types of retail.

Colliers International (2012) also notes that occupancy costs other than rent have risen. This is confirmed by the Shopping Centre Council of Australia (sub. 17, p. 6), who report that, per square metre of shop space, from 2009 to 2013:

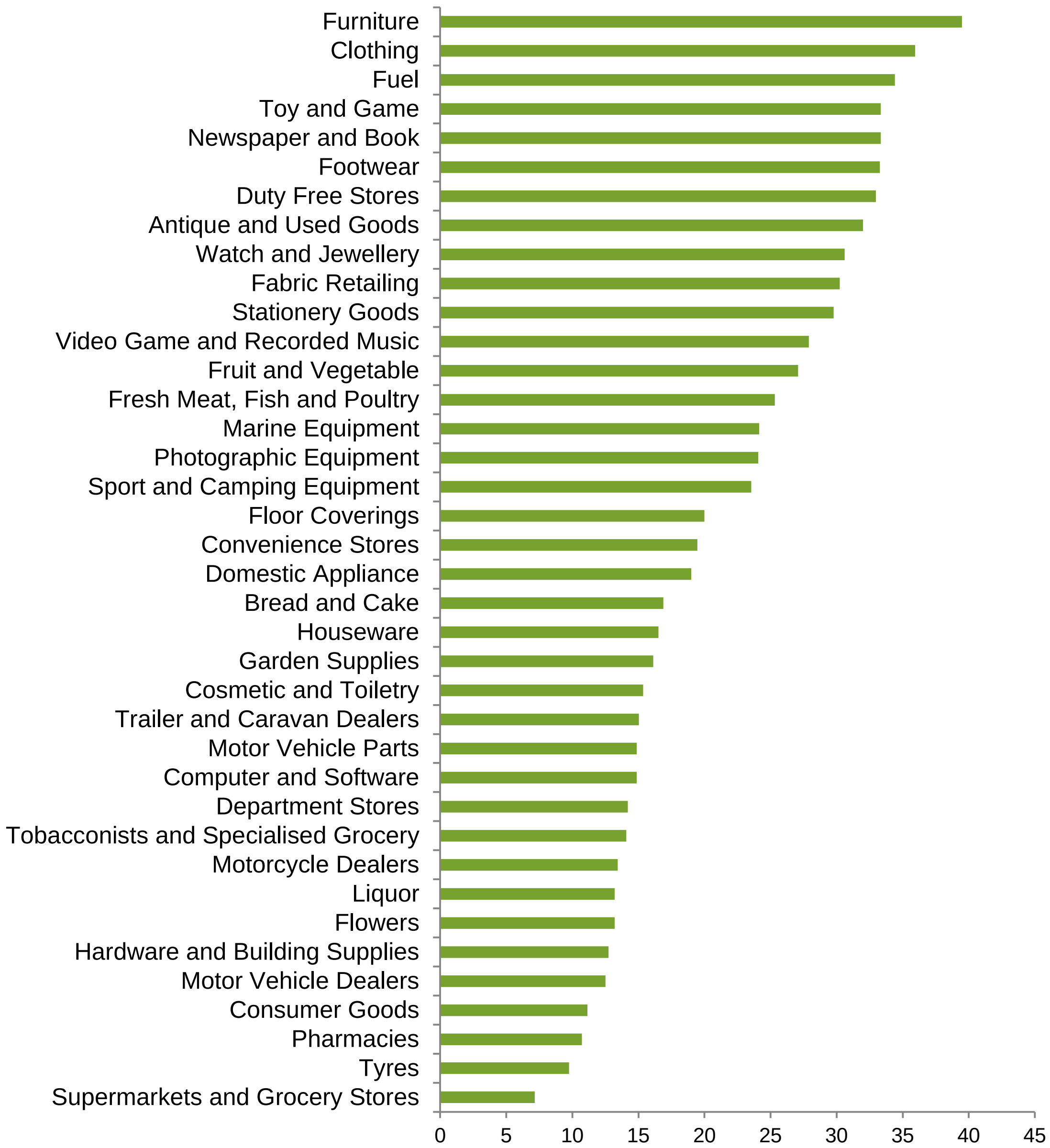
- electricity costs have risen by 36 per cent
- insurance premiums have risen by 34 per cent
- air conditioning costs have risen by 21 per cent
- common area cleaning costs have risen by 19 per cent

- repairs and maintenance costs have risen by 13 per cent
- security costs have risen by 2 per cent.

These costs are shared among tenants and with the landlords themselves according to the terms of tenancy agreements. As such, it is unclear how much of the increases listed above have been borne by retailers.

Figure 3.9 The significance of rent costs differs by retail subdivision

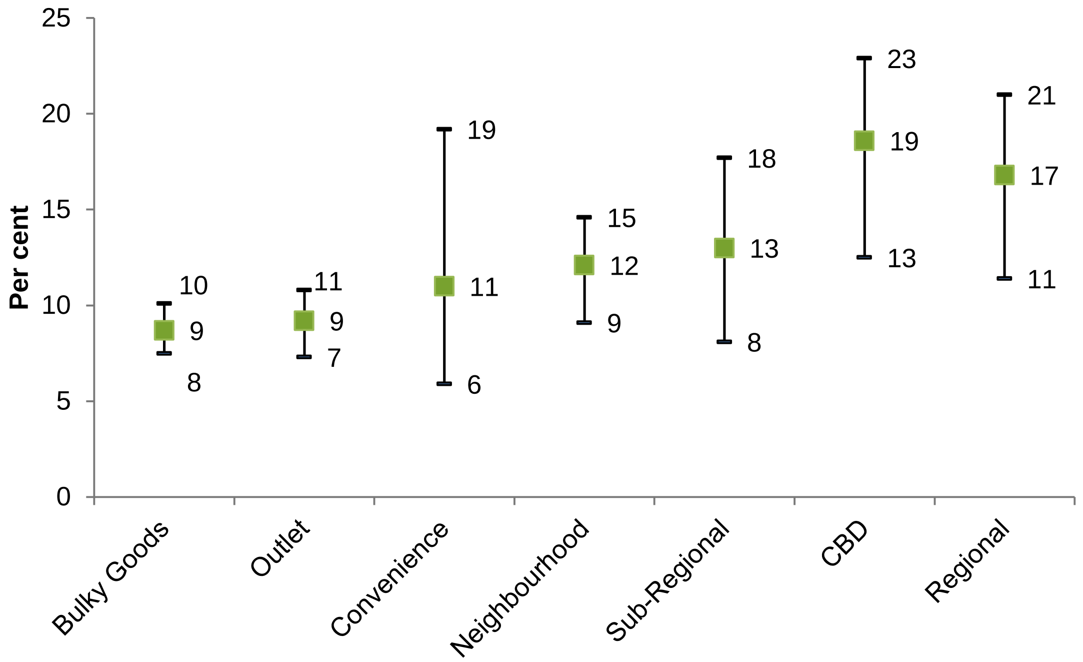
Rent as a percentage of costs of doing business



Data source: Ibisworld unpublished data.

Figure 3.10 **Occupancy cost ratios vary significantly according to location**[a]

Retailers' occupancy costs as a percentage of turnover; low, high and average; 2012



[a] Occupancy cost ratios are ratios of occupancy costs to turnover. Data relates to Australian listed and unlisted owners of retail property owners.

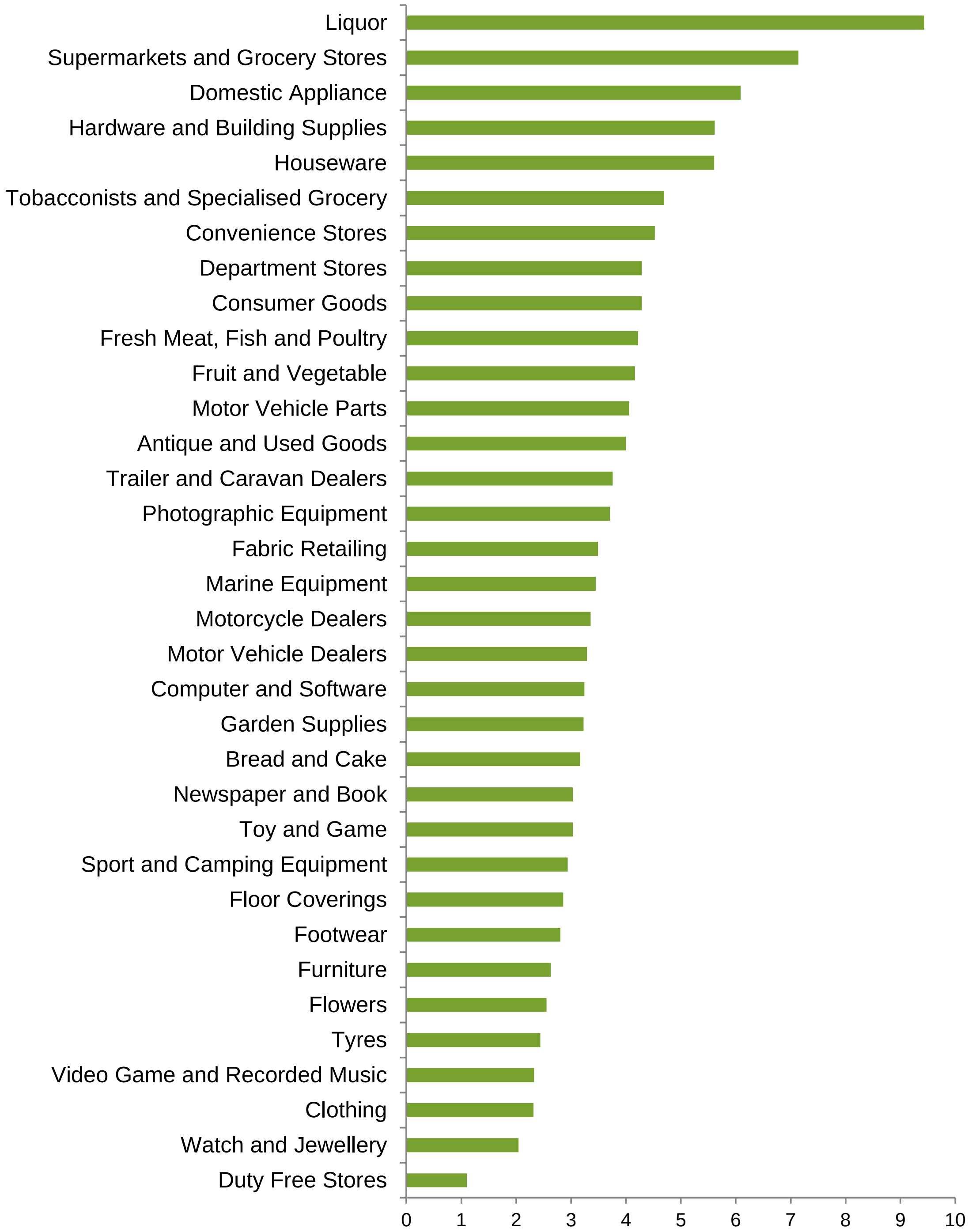
Data source: Colliers International (2012).

Energy and other utilities costs are more significant for food and liquor retailing

Energy and utilities costs comprise less than 5 per cent of expenses for the vast majority of retail subdivisions, though they are a more significant cost for liquor retailers, supermarkets and grocery stores (figure 3.11). Energy prices have experienced a significant increase in recent years, and several stakeholders have commented on energy prices as a significant cost issue (box 3.2).

Figure 3.11 **The significance of utilities costs differs by retail subdivision**

Utilities as a percentage of costs of doing business



Data source: Ibisworld unpublished data.

Box 3.2 **Stakeholders' comments on utility costs**

Energy and electricity costs were raised by several stakeholders:

> Energy is a crucial essential input for all retailers … Whilst the retail sector is one of the largest private employers in Australia it has been a neglected business sector in terms of publicly funded energy efficiency programs and services, unlike the commercial building or the domestic consumer sectors … Maintaining our competitive advantage in low cost energy is an important strategic economic and business goal for government. (Swimming Pool and Spa Alliance, sub. 5, pp. 7–8)
>
> Public policy also impacts on the disproportionate rate that smaller retailers pay for electricity … We have an example where in Edgewater Shopping Centre the independent liquor store pays 22 per cent more for electricity to run their lighting and refrigeration verses the supermarket in the same centre. Both charged from the same supplier and the supplier has the same cost to produce electricity and the same cost to deliver the electricity to both outlets. Usage for the supermarket is 28 534 [kWh per month] and the liquor store 8489 [kWh per month]. (WA Independent Grocers Association, sub. 2, p. 2)
>
> SA Water bases its water pricing on the capital value of land rather than actual water usage (although this is presently being reviewed). (Shopping Centre Council of Australia, sub. 17, p. 9)
>
> … the introduction of the Carbon tax and the ongoing operation of the renewable energy target (RET) have added significant pressure to businesses. (National Retail Association, sub. 18, p. 8)

Sources: SPASA, sub. 5; NRA sub. 18; WAIGA sub. 2; SCCA sub. 17.

INFORMATION REQUEST 3.1

The Commission is seeking further information on the costs of doing business (including costs of labour, capital, rent, energy, transport) across different categories of retailers operating in Australia.

- *To what extent have these costs changed in recent years?*
- *What is the impact of business size on cost structures?*
- *To what extent is e-commerce affecting cost structures? Which types of retailers are most affected?*

3.2 International cost comparisons

This section examines some of the differences in cost structures for the retail sector internationally, highlighting areas of apparent cost advantage and disadvantage for Australian retailers.

Methodological and data issues

Beyond providing very broad information on possible differences in the costs incurred by retailers, international comparisons, particularly those based on limited sample sizes or case studies, should be interpreted cautiously. Finding ‘like for like’ comparisons can be difficult and apparent differences may reflect a range of factors and preferences including business models, regulatory settings, resource endowments and societal choices. Further, it is often unclear which of these factors are responsible for the observed differences in the available comparisons. In some cases, further analysis will be necessary to identify the causes of variations in cost structures between countries. Therefore, apparent cost differences do not necessarily indicate a problem, or a problem amenable to policy change.

In addition, comparable and up-to-date data for undertaking meaningful comparisons of retail cost structures across countries are limited. The Commission has sought data from a wide range of sources — many of which have provided only anecdotal evidence, or evidence based on a small sample. In the absence of other data, the Commission has, at this stage, made extensive use of the Ibisworld dataset.

Participants’ views

Participants in this study expressed a number of views on differences in the costs of doing business in Australia relative to other countries (box 3.3). Most commonly raised was the issue of labour costs, although occupancy costs were also raised by a number of participants.

Box 3.3 **Participants' views on international cost differences**

Views on labour costs:

> The minimum wage in Australia is so far ahead of the rest of the world it is inconceivable to them, in most cases practically double. … Penalty rates must be reduced for Australian retail to be competitive around the world. … Australia is the only country in the world with such a long history in employer paid compulsory superannuation. … Australia is on a heading for 12% fully paid by employers, again, grossly uncompetitive with the rest of the world. (Frontline Hobbies, sub. 4, p. 3)

> The impact of a minimum wage rate which is over double that of the USA and approximately 50% greater than the UK, often dictates that an Australian business either reduces sales staff or increase prices to cover the associated costs. (BIA, sub. 8, p. 9)

> One sporting goods retailer noted that: 'We pay about ¥1000 (approx. $10) an hour (more than the minimum wage of about ¥800 (approx. $8)) at our store in Japan. That's less than half the Australian minimum wage.' (ASGA, sub. 10, p. 8)

> On our calculations, a US retailer in the same 'sit and fit' business as ours would pay staff little more than half our hourly rate at any time of the week, with no holiday or weekend penalties; and the US retailer would not be saddled with the same on-costs as Australian employers. (Gilmour's, sub. 11, p. 6)

Views on occupancy costs:

> … according to an international comparison by CBRE Research, three of Australia's capital cities were on the list of top ten international highest retail rental cities in the world. (Pharmacy Guild of Australia, sub. 12, p. 8)

> [A Shopping Centre Council of Australia commissioned report] found that, for regional shopping centres, average occupancy cost ratios (i.e. rent and other occupancy costs as a percentage of sales) for speciality stores were around 3.5 percentage points higher in Australia than in the US. For neighbourhood shopping centres, the average occupancy cost ratios are about 3 percentage points higher than in the US. (It should be noted, however, that this is not a perfect like-for-like comparison since specialty stores in Australia generally average only around 100 square metres while in the US such stores are usually around 400 square metres or more and include what in Australia are categorised as 'mini-major' stores.) … The major explanation for this discrepancy between the two countries is the much higher amount retail space per capita in the US compared to Australia. (SCCA, sub. 17, pp. 4–5)

Views on other issues:

> One snow sport goods retailer, with operations in both Australia and Japan, said: 'Domestic transport is very expensive in Australia compared to Japan. It costs us significantly more to get a container of goods from the port in Botany to our store in Sydney than it does to get the same sized container from the port in Japan to our store in the mountains two and half hours away.' (ASGA, sub. 10, p. 10)

> Because specialist businesses like ours are more common in the US than here, we are in a position to compare South Australia's bureaucracy with that in most American states, and we have concluded that starting a shop in California would be easier for us than struggling with Adelaide's archaic approach to planning. (Gilmour's, sub. 11, p. 4)

INFORMATION REQUEST 3.2

The Commission is seeking further information on relative cost structures between Australian retailers and those operating in comparable markets overseas.

- *How do the costs of doing business differ between retailers in Australia and those operating overseas?*
- *To the extent that there are significant differences in cost structures, what are the key drivers of these differences?*
- *To what extent are any cost differentials driven by the different mix of in-store and online retailing?*
- *To what extent are there differences in sales per employee between Australian and overseas retailers? What are the main drivers of any differences?*

Gross margins and cost structures are variable and inconclusive

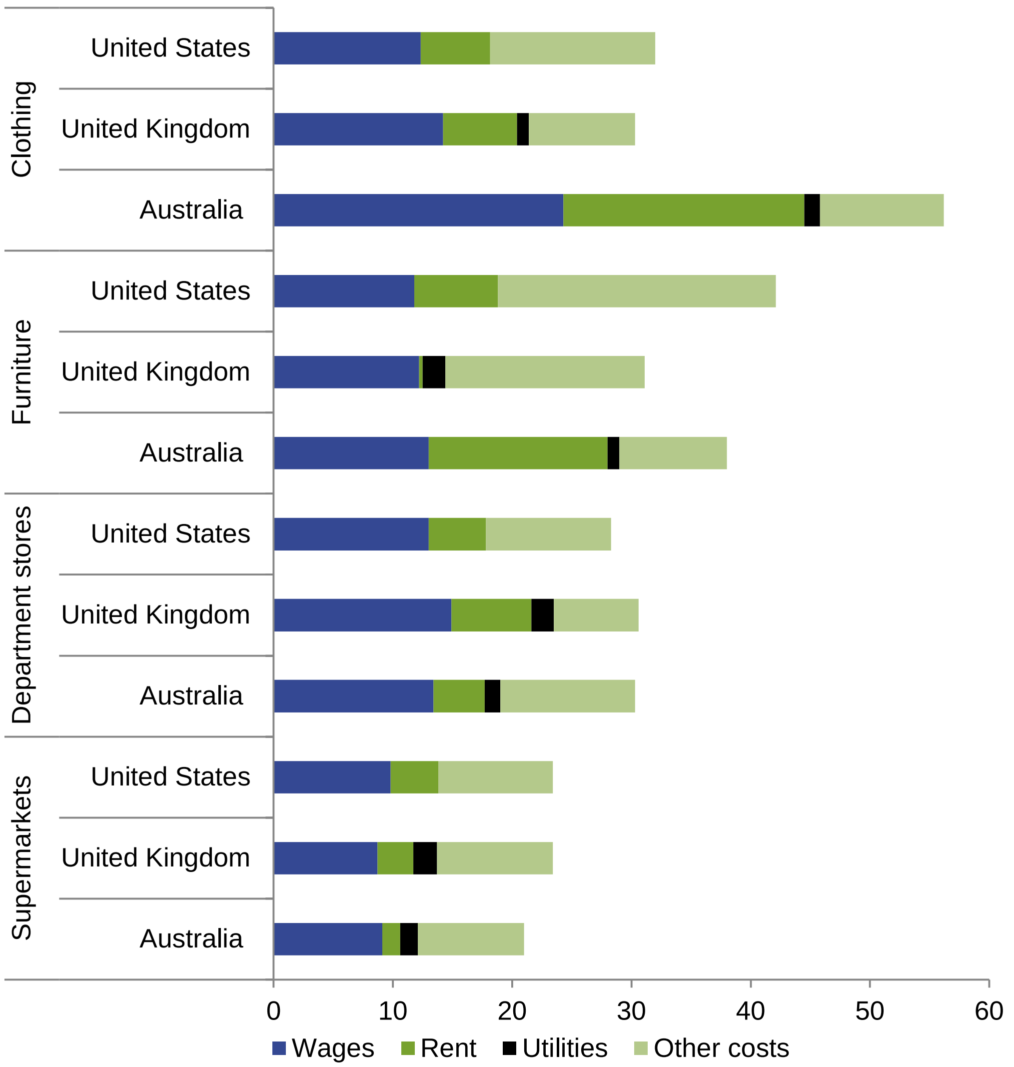
Gross margins are highly variable across retailers and will depend on the type of goods sold and the business model employed. Available evidence on internationally comparable gross margins and cost structures is patchy and generally inconclusive. Further, apparent differences in gross margins, and their composition, across countries do not necessarily indicate higher or lower net margins or profitability.

Ibisworld data suggests that for some retail categories there are no discernible differences in cost structures between Australian retailers and those operating in broadly comparable markets overseas. However, for other retail categories, clothing for example, Australian retailers have relatively high cost shares for labour and rent (figure 3.12).

Selected international comparisons of broadly comparable retailers show no distinct pattern in reported gross margins. In a comparison of Australian and international department stores, Citi (2012) compared David Jones with two US retailers, Nordstrom and Saks; and Myer with the UK retailer John Lewis and the US retailer Macy's (table 3.3). According to this analysis, the costs of doing business (excluding rent) were relatively lower for the respective Australian businesses. Citi also noted both the relatively low sales density and staffing levels of the Australian department stores. For example, sales on a per square metre basis for John Lewis were estimated at around three times that of Myer. This was attributed to fewer stores, much higher staffing, substantial online sales and a sales mix more heavily weighted towards home electronics.

Figure 3.12 **International cost structure comparisons, selected categories[a]**

Costs of doing business as a percentage of revenue[b]



[a] Utilities are combined with rent for the United States. 'Clothing' for the United States is calculated as a revenue weighted average of the reported cost structures for the categories: 'family clothing', 'men's clothing', 'women's clothing', and 'children's clothing'. Data are estimates for various years — 2013, 2013-14, 2014. [b] Excludes cost of goods sold and profit.

Data source: Ibisworld Industry reports.

Table 3.3 **International department store comparisons, 2012**

Store	*Reported gross margin*	*Cost of doing business, excluding rent*[a]	*Sales per square metre*[b]
	%	%	$
David Jones	37.5	10.8	3 435
Nordstrom	45.5	22.5	4 380
Saks	41.6	18.1	4 332
Myer	41.0	24.4	2 570
John Lewis	39.8	29.0	7 706
Macy's	40.4	26.3	1 796

[a] Excludes rent, occupancy and depreciation for David Jones, Nordstrom and Saks. Excludes rent and depreciation for Myer, John Lewis and Macy's. [b] Sales were converted to AUD assuming AUD/USD = 1.04 and AUD/GBP = 0.65. Sales includes online sales (about 20 per cent of John Lewis's sales are online).

Source: Citi (2012).

An even more specific example cited by Citi, comparing the global and Australian performance for the retailer Zara, suggests that higher costs of doing business do not necessarily mean lower profitability (table 3.4). This suggests that any cost disadvantages incurred in the Australian market are, at least partly, offset by price advantages.

Table 3.4 **Comparing Zara's performance, 2012**

	Zara Group	*Zara Australia*
	%	%
Gross margin	58.6	66.7
Cost of doing business	37.4	41.8
EBIT margin	21.1	24.9

Source: Citi (2014).

Labour costs are relatively high in Australia …

Labour costs account for the largest component of the cost of doing business for many retailers (figures 3.7 and 3.8) and have been raised as a particular area of concern by participants in this study (box 3.3). The key issues are higher minimum wages, as well as factors such as penalty rates, the lack of flexibility under the industrial relations system and level of superannuation.

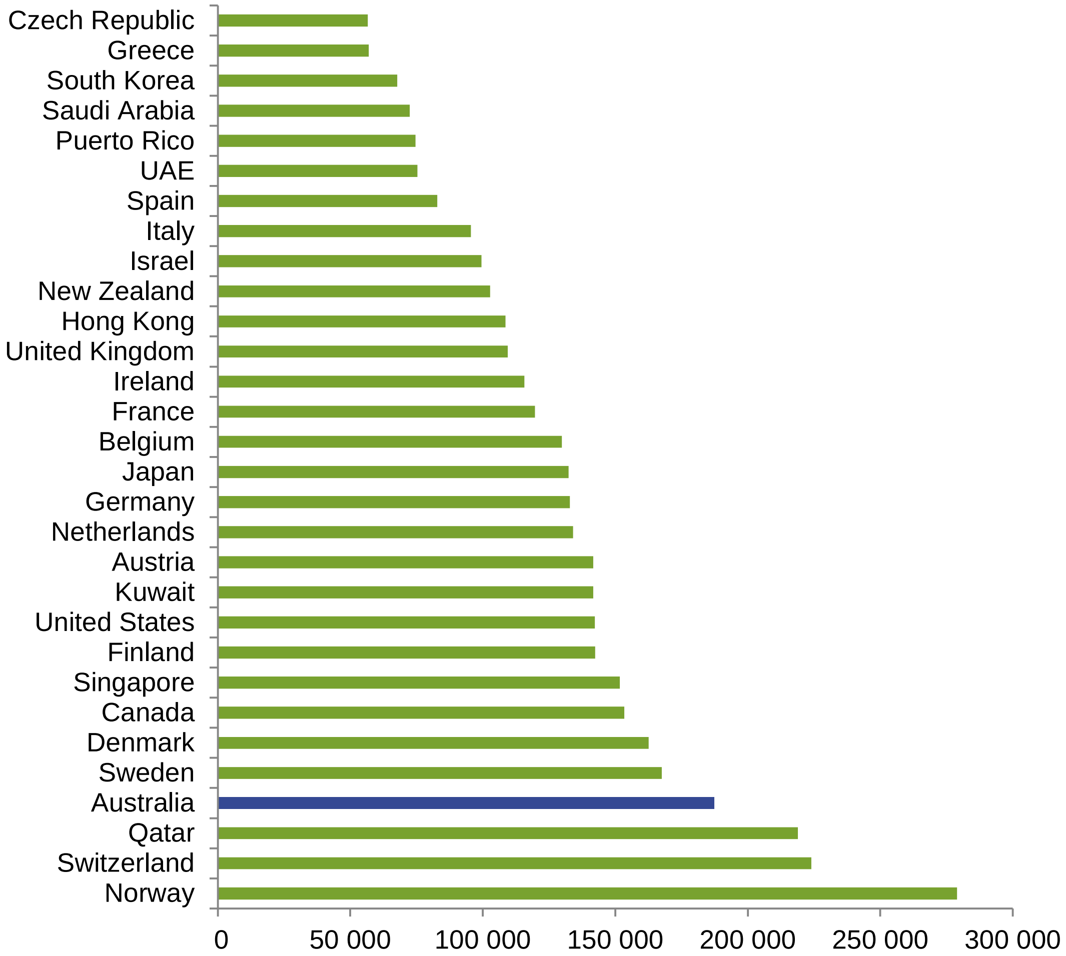
In a recent analysis of Australian retail wages, Citi (2013) noted:

> We have looked at comparisons of wage rates between countries, but the exercise is difficult given the variation in the use of commissions and other payment benefits like healthcare. For reference, in Australian dollars, the award rate in retail is $18 per hour.

In New Zealand, the pay rate is A$11 and in the US minimum pay is $7.71, but the median wage is A$10. (p. 11)

However, while wages might be higher in Australia, overall differences in labour cost shares may not be so pronounced if less labour is employed relative to sales. As an example, in an international comparison of ‘family clothing’ retailers, estimated sales per employee were relatively high in Australia (figure 3.13). These results should be interpreted carefully, given potential differences in service and product offerings across countries, as well as factors such as exchange rate variability.

Figure 3.13 **Estimated sales per employee (‘family clothing’ retailers), 2014[a]**
US dollars



[a] Figures are estimates for 2014. Data for highest 30 countries is presented. Family clothing stores is an industry classification under the North American Industry Classification System (NAICS 44814).

Data source: Barnes Reports (2014).

… and so are occupancy costs

As discussed in the above section, occupancy costs often represent a significant share of a retailer's cost of doing business, although this is highly variable depending on the category of retailer (table 3.2). Relatively high occupancy costs in Australia was also an area of concern raised by participants (box 3.3).

Data on specialty retail rents from Westfield shopping centres suggest that occupancy costs in Australia are relatively high, both in per square metre terms and as a share of sales (table 3.5). As a share of sales, occupancy costs in Australian centres are around a third higher than in the United States and the United Kingdom.

Table 3.5 **Westfield shopping centre performance by country, 2013[a]**

	Specialty retail sales	*Specialty store rent*	*Rent, share of sales*	*Occupancy cost, share of sales*
	$/m^2	$/m^2	%	%
Australia	9 901	1 537	15.5	19.2
New Zealand	7 859	1 038	13.2	19.2
United States	7 014	891	12.7	14.6
United Kingdom	16 442	1 423	8.7	14.0

a Values converted to Australian dollars using exchange rates listed in publication. Occupancy cost percentage is reported as a combined figure for Australia and New Zealand.

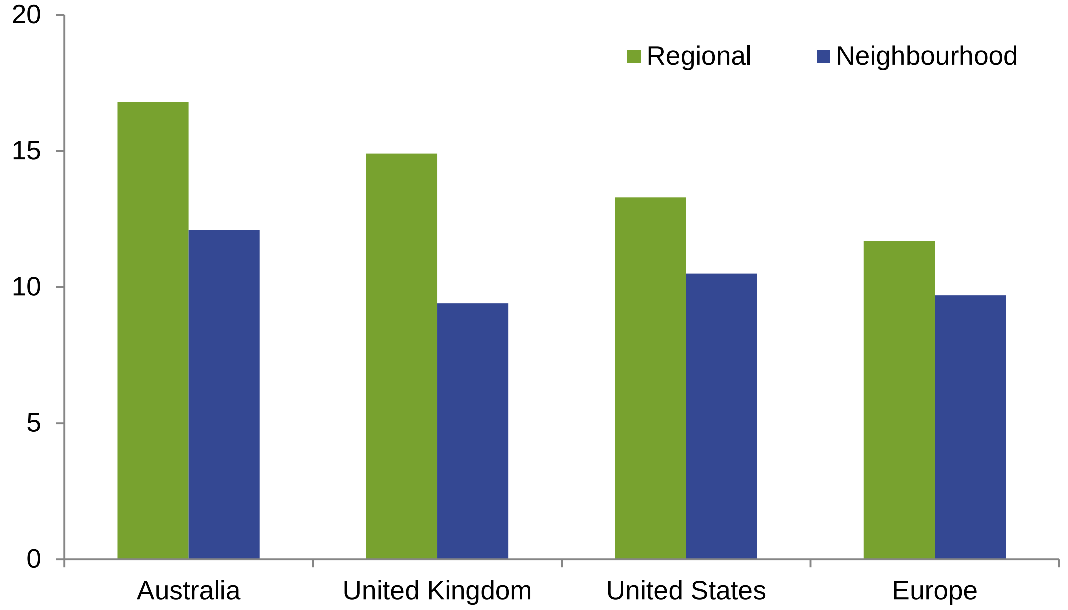
Source: Westfield (2014).

A broader analysis by Colliers International, comparing occupancy cost ratios in both 'regional' and smaller 'neighbourhood' shopping centres also indicates that occupancy costs, relative to sales, are relatively high in Australia (figure 3.14).

One of the drivers of occupancy costs is the volume of retail space in respective countries. This is likely to be driven by a range of factors, including planning and zoning, and taxation regimes. For example, there is around twice the amount of retail space per person in the United States, so rents are likely to be lower and vacancy rates higher than in Australia. Colliers International (2012) noted that average vacancy rates in Australia were 0.9 per cent for regional centres and 3.6 per cent for neighbourhood centres, while in the United States they were 7.2 and 8.3 per cent respectively.

Figure 3.14 **Occupancy cost ratios by region, 2012[a]**

Per cent of sales revenue



[a] Occupancy cost ratios are occupancy costs (rent and other costs) as a share of sales revenue.

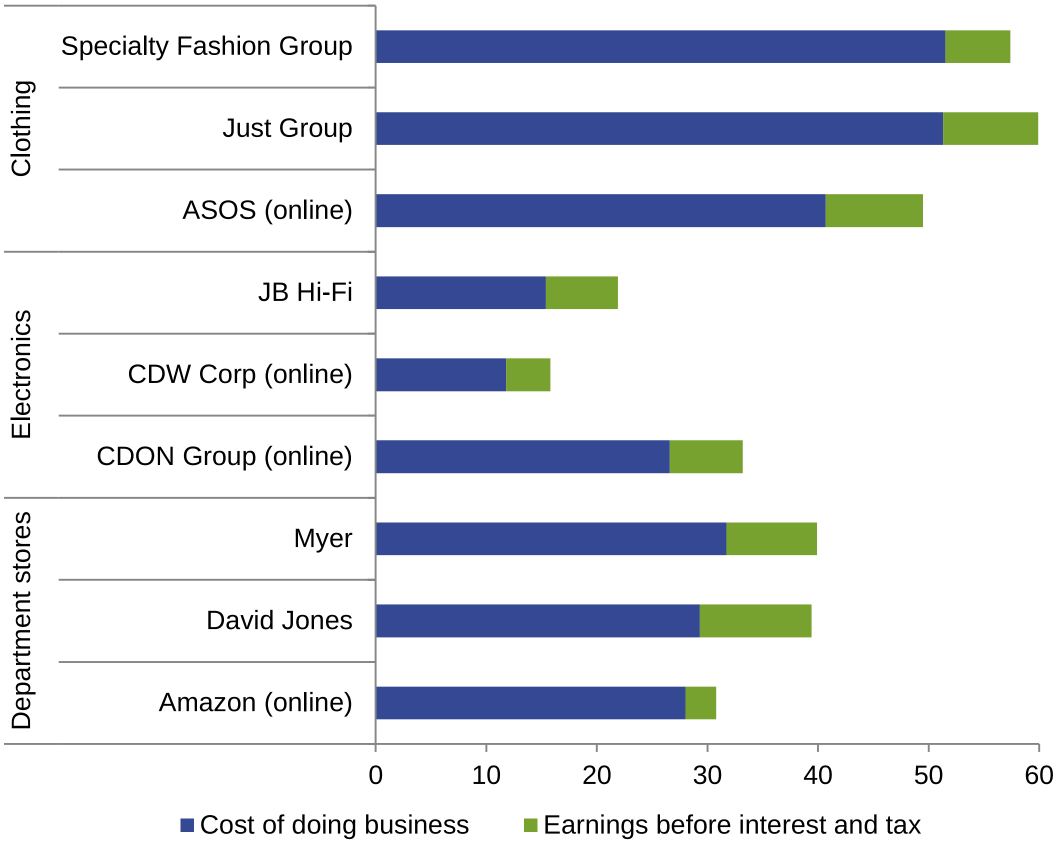
Data source: Colliers International (2012).

Relative costs for online retailers

Bricks and mortar retailers are increasingly facing competition from online sales, both locally and from overseas-based sellers. Whilst dated, a 2011 comparison by Citi of the gross margins of Australian retailers against their online overseas competitors reveals that the costs of doing business, as a share of sales, can be lower for overseas retailers than broadly comparable Australian retailers, although not in all cases (figure 3.15). These figures should be treated with caution, given the particular difficulty in comparing like with like in these cases. As the figure indicates, the category of retail has a large bearing on the costs of doing business for both online and bricks and mortar retailers.

Figure 3.15 **Australian retailers versus overseas online retailers — cost comparisons, selected categories[a]**

Per cent of revenue



[a] Based on average financial results for two years to 2011. Cost of doing business is the gross margin less earnings before interest and tax.

Data source: Citi (2011).

The composition of online retailers costs differs from that of traditional retailers. While online retailers have a cost advantage through not operating physical stores, they can have significant warehousing and distribution costs — depending on their business model (such as their shipping and returns policies). Accordingly, many are reliant on scale and have relatively small net profit margins (Citi 2011).

Another feature to note about the online market is that it consists of both purely online retailers and multi-channel retailers. Although potentially dated, considering the rapid evolution of the online retail segment, Citi (2011) noted that many of the most successful online sellers in the United States were multi-channel retailers, but in Australia the online sales penetration of the major listed retailers was relatively low. The New Zealand Productivity Commission (2014) also recently noted that some US retailers are reducing their store footprint and increasing online sales in a move to compete with online only retailers.

4 Policy and regulatory drivers

Key Points

- Retail costs are driven by a combination of geography, market forces, business decisions and government policies and regulations.
- For most retailers, government policies affecting labour markets (particularly the Fair Work Act) and the cost and availability of retail space (state and local government planning and zoning laws) are key determinants of their overall cost structures.
- On labour costs, concerns raised in submissions and discussions have included the level of wages, the growth in real wages, penalty rates, labour on-costs (workers compensation and superannuation), the costs of negotiating enterprise bargaining agreements and inconsistencies in Fair Work Act outcomes.
- Rent and occupancy costs also account for a substantial share of many retailers' costs of doing business in Australia. A number of submissions have pointed to what they view as unnecessarily restrictive approaches to planning and zoning by state and local governments that are contributing to higher costs for retailers — both in terms of rents and compliance.
- The retail sector has provided other examples of inconsistent, highly prescriptive and seemingly ad hoc rules and regulations. The sector continues to labour under regulations that are out of step with changing shopping patterns. These include restrictions on trading hours across and within jurisdictions, and restrictions on what can be sold at particular times.
- Other concerns raised include: costly or inconsistent regulations (and at times their subjective interpretation) for issues relating to product labelling, food safety and delivery restrictions; large increases in the cost of utilities services; and marked differences in the level of state and local government taxes and charges across jurisdictions.

As highlighted in chapter 3, the main cost components of retail businesses in Australia are labour costs and occupancy costs. Not surprisingly, submissions to both this study and previous Commission inquiries relevant to the retail sector have focused on costs in these areas.

In general, retail costs are driven by a combination of market forces, business decisions and government policy. All three drive the level of costs in retailing, as well as the mix or spread of total costs across the three main input categories — labour, capital and intermediate inputs.

In relation to market forces and business drivers of costs, retail businesses are constantly assessing what they sell, how they sell it and what prices they sell it for, based on developments in retailing technology, changes in the prices of key inputs, changes in consumer tastes and preferences, and the development of new products. Like most businesses, retailers adjust their costs and cost structures in response to both market threats (actual and perceived) and market opportunities.

The challenge of responding to market driven cost pressures is largely the responsibility of retail businesses, and is a normal part of business operations in a market based economy. While important to analysts and retailers themselves, market driven changes to costs and cost structures in retailing are not the focus of this study.

On the other hand, the costs of doing business in the retail sector are also influenced by government policy and regulation. To the extent that governments do not achieve their policy and regulatory goals and objectives at least cost — because of flaws in the intent, design or implementation of policies and regulations — the end result will be a retail sector that is less efficient and competitive than might otherwise be the case.

The remainder of this chapter considers how policy and regulatory issues contribute to the main cost components of retailing identified in the previous section — that is, labour, occupancy, and other intermediate input costs.

4.1 Labour cost drivers

As labour costs are the single largest cost component for most retailers, government policies and regulations that influence the quantity of labour they must hire or the price they pay for it (terms and conditions) are important cost drivers.

The major policy levers of relevance to the retail sector's labour costs are workplace regulations, particularly those established by the Fair Work Commission under the Fair Work Act. The Fair Work Commission regulates and enforces provisions relating to minimum wages and employment conditions, enterprise bargaining, industrial action, dispute resolution, and termination of employment.

As noted by the Commission in its 2011 study of the retail sector, employers in this sector are among those most affected by minimum wage decisions because of the comparatively higher level of employment in the retail industry subject to minimum award wages (that is, relative to industries with a higher incidence of over award or enterprise agreement-based pay). Also, the coverage of employees in small retail businesses tends to be higher than in larger businesses that typically make greater use of enterprise agreements.

Retail sector labour costs are also influenced by other government policies and regulations, such as those relating to occupational health and safety requirements, trading hours, and packaging and labelling and food safety standards. However, these policies and regulations are arguably drivers of other retail cost components — occupancy costs and intermediate input costs for example — as much as they are drivers of labour costs.

The remainder of this section is focused on workplace regulations as the key driver of retail sector labour costs. The other policy and regulatory drivers of retail costs mentioned above are considered later in this chapter.

Stakeholders' views on labour costs

Submissions to this study have raised a number of concerns regarding labour costs, including concerns about the general level of wages in the sector, the growth in wages relative to output prices, penalty rates, labour on-costs (workers compensation and superannuation), the costs of negotiating enterprise bargaining agreements, and inconsistencies in the decisions of the Fair Work Commission (see participants views in box 4.1).

Box 4.1 **Participants' views on workplace regulations**

Australian National Retailers Association (sub. 16):

> … the national wage decision (is) pivotal in determining the trajectory of wages costs for the sector. The penalty rate structure … also has a significant influence on the total retail workforce cost (pp. 10–11)

Frontline Hobbies (sub. 4):

> Penalty rates must be reduced for Australian retail to be competitive. … The Superannuation Guarantee Act 1992 stipulates minimum earnings of $450 gross per month as the entry level threshold for employers to pay employees' superannuation contributions. This threshold has not changed for twenty two years, has not kept pace with wages or been indexed. (p. 1)

Coles (sub. 7):

> The Minister for Employment, Eric Abetz, announced a review of the Safe Rates Tribunal on 20 November 2013. The Review will be completed in the first quarter of 2014. This should be progressed before the Tribunal makes any determinations. (p. 3)

(Continued next page)

Box 4.1 (continued)

Swimming Pool And Spa Alliance (sub. 5):

> Although penalty rates increase the take home income of workers lucky enough to be employed, their higher wages come at the expense of other workers who are shut out of the labour market. (p. 5)
>
> Australia's industrial relations regulation is too rigid, which compromises retail economic growth and obstructs productivity gains. (p. 6)
>
> The Fair Work legislation continues to remain a concern as it assumes a 'one size fits all' approach to industrial relations whilst imposing unnecessary cost burdens on businesses and limited work choices to employees. (p. 6)
>
> Retailers also face increased costs through compulsory arbitration that forces outcomes which almost always go beyond minimum standards. Further, there is also legislative emphasis on process rather than outcomes, which increases delays and related costs. (p. 6)

National Retail Association (sub. 18):

> … the current workplace relations regime has prompted a significant proportion of smaller retailers either to remain closed on Sundays, or to limit employment at those locations to proprietors and family members only, thus obviating the need to pay significant penalty rates to staff. Other businesses have reported that they simply no longer open their doors on Sundays. This not only denies their staff the opportunity of work, but it also hinders profitability by forcing the business to recover its fixed costs over a shorter trading period each week. (p. 6)
>
> One of the greatest frustrations the retail industry has with the current (industrial relations) system is the wide variance in outcomes and the discrepancies in decision making. (p. 8)

Small Business Development Corporation (sub. 9):

> Currently, Western Australia is the only State to have retained its own industrial relations ('IR') system. Depending on their company structure, this has resulted in some retailers falling under the State Award with other retailers complying with the Federal Modern Awards as part of the Australian workplace system.
>
> Having two separate IR systems creates advantages and disadvantages for retailers as the provisions available in each system's awards are non-identical. In particular, the classification of penalty rates and when they apply can provide a significant advantage to one retailer over another depending on certain circumstances. (p. 2)

On the other hand, while unit labour costs are higher in Australia, other stakeholders have argued that the quality of labour in Australia is also higher, and that there *is* sufficient flexibility in existing award provisions for employers. The Shop, Distributive and Allied Employees' Association (SDA), for example, submitted that:

> The SDA totally rejects the idea that wage and / or labour costs are an impediment to effective competition in the retail industry.
>
> … the modern retail award is characterised by a high degree of flexibility in regard to employment terms. (sub. 6, pp. 3–4)

As participants to this study have acknowledged, the current study provides an opportunity to document and present policy problems for the attention of governments, including those relating to the cost of labour. The Commission will be doing further work following this interim report to follow up on the material already provided or cited.

The Australian Government has foreshadowed a broader inquiry into the Australian Fair Work Act. The current study will be one input into that broader review of the Australian labour market.

4.2 Occupancy cost drivers

Policy and regulatory issues that contribute to retail occupancy costs include planning and zoning laws and retail tenancy laws. Submissions to this study have questioned whether inefficiencies in these areas could be leading to higher retail and commercial rental rates than would otherwise be the case (see participants views in box 4.2).

As noted in chapter 3, there is some evidence that the quantity of available retail space is comparatively low in Australia, and that retail and commercial rents are comparatively high. To the extent that the latter is caused by unnecessarily restrictive approaches to planning, zoning and development applications by state and local governments, the Australian retail sector could be less competitive than would otherwise be the case. Moreover, in an environment where globalisation of the retail sector and the rapid uptake of online shopping by Australian consumers are putting pressure on Australian retailers and suppliers of retail space, the need to ensure that Australia's planning and zoning processes and retail tenancy laws are as efficient as possible is arguably even more important.

The Commission has previously argued that there is substantial scope to reduce occupancy costs by improving the efficiency of retail property markets. For example, the Commission previously estimated that implementing just two reforms to development assessment processes that apply to commercial and industrial sector applications (which includes applications for retail space) — greater use of electronic processing and increased use of code-based assessment — could generate net cost savings to the nation of around $240 million per year (PC (2012b)). Australia's comparatively prescriptive retail tenancy laws have also been mentioned in submissions to this study as a contributor to Australia's comparatively high retail occupancy costs. As noted in chapter 5, the extent of progress on reforms to retail tenancy laws recommended by the Commission following a review in 2008 has been variable across jurisdictions.

INFORMATION REQUEST 4.1

The Commission is seeking further information on the impact of planning and zoning laws on occupancy costs.

To what extent are occupancy costs also influenced by the behaviour of retail property owners?

Box 4.2 **Participants' views on planning and zoning, and retail tenancy**

Planning and zoning

Large Format Retail Association (sub. 19):

> There is … a need for periodic review of planning policy to ensure that the policies and regulations in place are relevant in our economy and society. … This is particularly relevant in the past few years where retailing has been under pressure from adverse economic conditions; changes in consumer behaviour; price harmonisation; globalisation and the increasing market share of internet based retailing. In recent times there has been some major reviews undertaken which have identified the need for changes to planning policy. This is timely given that there has never been a greater need for planning to keep pace with the market it seeks to regulate. (p. 9)

Gilmour's (sub. 11):

> An occupancy factor which affects our competitive position remains the issue of zoning. As we explained in our 2011 submission, this limits our expansion and viability. Right now we are still trying to negotiate the minefield of bulky goods/general retail zoning to set up a new shop in Adelaide …
>
> With many retailers … we are alarmed by the concentration of ownership of major shopping centres in so few hands, and by the heavy handed approach that this monopolisation has spawned. (p. 3)

Shopping Centre Council of Australia (sub. 17):

> … [rent and tenancy cost impacts from planning and zoning] include issues in relation to regional planning schemes, zoning, definitions, development approvals, design requirements, land owner consents, prescriptive controls, state agency conditions, community consultation requirements and infrastructure charges and contributions. (p. 12)
>
> The most comprehensive pursuit of [planning and zoning] recommendations was the Victorian Government's zoning reforms which commenced in 2013 … even in the case of Victoria's reforms … it could be interpreted that it inadvertently picked winners and has not fully enabled competitive neutrality. (p. 14)

(Continued next page)

Box 4.2 (continued)

Australian Retailers Association (sub. 14):

> Planning and zoning in some states has improved, as have retail trading hours, but more work could still be done in these areas. (p. 5)
>
> The Council of Australian Governments (COAG) should be the recommended body used to facilitate a national approach which will create a greater availability of retail space in retail activity areas driven by the Federal Government. (p. 25)
>
> The dependency on securing tenancies within shopping centres poses a significant structural challenge for the ongoing viability of the retail sector. The oligopolistic nature of shopping centre ownership and a retail tenancy regime which is skewed in favour of these large-scale landlords both present an inherent disadvantage to Australian domestic bricks and mortar retailers in terms of equitable competition. (p. 21)

Australian Sporting Goods Association (sub. 10):

> Part and parcel of (the need for increased) transport infrastructure spending must be (to) ensure the availability of land and planning approval for warehousing space in the right geographic areas. (p. 10)

Regulation of tenancy and rental agreements

Small Business Development Corporation (WA) (sub. 9):

> [A] significant outlay for ('bricks and mortar') retailers is the cost associated with leasing retail premises. … legislation regulating commercial tenancy agreements varies across States and Territories. In Western Australia, the Commercial Tenancy (Retail Shops) Agreements Act 1985 ('the CT Act') provides some protections for retail shop tenants. (p. 2)

Australian Sporting Goods Association (sub. 10):

> High rents and an opaque leasing process are part and parcel of the major challenges faced by retailers. Broadly, ASGA is concerned with retail tenancy issues including: the power imbalance between landlords and retailers currently in favour of landlords; transparency of information available to both parties; security of tenure; the use of retail turnover to determine occupancy costs; rent and fit-out costs. (p. 6)

Shopping Centre Council of Australia (sub. 17):

> The market for retail tenancy leases in Australia is now heavily regulated. In all States and Territories there is very detailed and prescriptive legislation regulating all aspects of the retail tenancy relationship, beginning even before a tenant signs a lease. … Retail tenancy legislation adds substantially to regulatory, administrative and compliance costs and, where market conditions permit, these costs are passed on to retailers and to consumers. (p. 16)

Australian Retailers Association (sub. 14):

> The majority of [previous] recommendations [on rent and tenancy costs] centre on improving the transparency in the retail lease/property market and repairing the imbalance in access for information for retailers. Unfortunately, we must report that it would appear that NONE of these recommendations have been implemented by COAG, who were charged with the responsibility … (p. 25)

4.3 Other retail cost drivers

Apart from labour and occupancy costs, retailers incur significant costs for a range of other inputs, including utilities (electricity, gas, water and waste services), transport and warehousing services, and other materials and services. Government policies and regulations can influence the prices of these inputs or the quantities of these inputs that retailers purchase.

The relevant policy and regulatory drivers of these costs include: controls over retail trading hours; regulations governing transport and warehousing (including controls over delivery times); laws governing product labelling and packaging and food safety; quarantine and other controls over the interstate movement of goods; and regulations governing the supply of electricity, gas and water services.

Restrictions on trading hours are still an issue in some jurisdictions

Restricted trading hours means that there is less choice for consumers as to when they can shop. At a time when shopping patterns are changing considerably, restrictions on trading hours run the risk of being increasingly out of step with community expectations.

Beyond the costs to consumers, regulations on trading hours (either time of day or day of week) also have efficiency costs for retailers. A retailer forced to close earlier than desired suffers from excess capacity, since capital investment (for example, plant and equipment) is not fully utilised. Moreover, being forced to close on Sundays, for example, prevents retailers from managing their stocks better, especially those of highly perishable goods like fruit and vegetables. More produce is wasted and last minute sales are more frequent.

There are also additional compliance and operational costs to retailers who trade in all states. These costs become more acute around the time of gazetted public holidays, when retailers have to interrupt ‘normal’ trading arrangements and put in place different arrangements to comply with the diverse public holiday trading arrangements set down in different states, different regions and different local trading precincts across Australia.

While some gains have been made across Australia in the deregulation of retail trading hours, inconsistencies remain across and within jurisdictions. Trading hours are effectively deregulated in Victoria, Tasmania, the Northern Territory and the Australian Capital Territory and are largely unrestricted in New South Wales. However, they are most restricted in South Australia, Western Australia and Queensland, and are inconsistent within these jurisdictions.

The complexity of retail trading hours restrictions is illustrated in table 4.1.

Table 4.1 **Public holiday trading hour restrictions**[a]

Public Holiday ■

	Good Friday 29 March	*Easter Saturday 30 March*	*Easter Sunday 31 March*	*Easter Monday 1 April*	*Anzac Day 25 April*
Vic	■ Closed	■ P/H Trade	□ Normal	■ P/H Trade	■ Closed until 1:00 pm
NSW	■ Closed	■ P/H Trade	■ Restricted	■ P/H Trade	■ Closed until 1:00 pm
ACT	■ P/H Trade[c]	■ P/H Trade	□ Normal	■ P/H Trade	■ P/H Trade[b]
Qld	■ Closed	■ P/H Trade	□ Restricted	■ P/H Trade	■ Closed
SA	■ Closed	■ Restricted	□ Restricted	■ Restricted	■ Closed
NT	■ P/H Trade[c]	■ P/H Trade	□ Normal	■ P/H Trade	■ P/H Trade[b]
WA	■ Closed	□ Normal[e]	□ Restricted	■ Restricted	■ Closed
Tas	■ Closed	□ Normal	□ Normal	■ P/H Trade	■ Restricted[d]

[a] Normal = normal. P/H Trade = stores may trade on a declared public holiday, public holiday rates of pay apply. Restricted = stores may trade only in some areas of the state or for restricted hours. [b] It is recommend that stores are closed until 1:00 pm. [c] It is recommend that stores are closed. [d] Stores must remain closed until 12:00 pm.

Source: Coles (sub. 7, p. 6).

The importance of the trading hours issue was raised in many submissions to this study:

> Trading hour restrictions need to be urgently reviewed to cater for the modern consumer who wishes to shop on their terms. (Swimming Pool And Spa Alliance, sub. 5, p. 9)

> There has been some reform towards less restrictive trading regimes in a few states, but significant further action is needed to deliver appropriate regulation of trading hours across Australia. (Australian National Retailers Association, sub. 16, p. 6)

> Regulation of trading hours, particularly restrictive trading days on public holidays, is inconsistent across State jurisdictions, causing added complexity and cost and lost income for retailers. … For each of these trading times, there may be an additional layer of restriction on the: maximum number of employees staffed at any one time, floor size of the shop, and types of goods sold. … in addition … there are also restrictions within States/Territories on when retailers are permitted to trade. [And] in some States/Territories trading hours are regulated by multiple legislative instrument. For example, in New South Wales retailers must comply with trading restrictions prescribed in both the Liquor Act 2007 and the Shop Trading Act 2008. (Coles, sub. 7, p. 5)

> Regulations prevent Masters Home Improvement stores from trading in line with the hours enjoyed by other hardware stores. To be eligible to trade as a 'domestic development shop' Masters must only sell those goods which are prescribed by the Retail Trading Hours Regulations 1988. The regulation prescribes a list of what a 'domestic development shop' can sell which gives rise to all sorts of inconsistencies and anomalies. The regulation:
>
> - Allows the sale of light bulbs but prohibits the sale of light fittings
> - Allows the sale of outdoor lighting but prohibits the sale of indoor lighting
> - Allows the sale of kitchen sinks but prohibits the sale of dishwashers
> - Allows the sale of wood-fire heaters but prohibits the sale of gas heaters
> - Allows the sale of indoor television antennae but prohibits the sale of outdoor television aerials. (Woolworths, sub. 13, p. 2)

A retailer has explained to the Commission that 29 of their stores cannot trade on Sundays, leading to a loss of 1508 trading days each year. This is equivalent to having a fully stocked supermarket closed for more than 4 years (4.12 years).

On the other hand, the SDA (sub. 6, pp. 4–5) argued against the need for further deregulation of retail trading hours. Reasons given included a lack of public and business appetite for further reform, and the need for a better work life balance for smaller family-run businesses.

> In one state (WA), where there are some limited restrictions (on trading hours), the public voted in a recent [2005] referendum to maintain the status quo.
>
> Where trading hours have been liberalised, many employers, especially in the discretionary spend areas, do not utilise all of the opening hours available to them.
>
> There is no evidence to show that there is any nexus between length of trading hours and impact of on line shopping.
>
> … What also must be taken into account is the need for balance between the needs of major retailers and the needs of employees and small business operators. The latter groups do need time away from work for family and leisure purposes. For employees this means the opportunity for 'voluntary work' on public holidays and Sundays, and for retailers, the right not to be forced by major shopping centre managements to open on public holidays as a condition of the maintenance of their lease.

The SDA (sub. 6, p. 2) argue that there is:

> ' … no justification in any further extension of retail trading hours.'

While stakeholders acknowledge that trading hours are fundamentally a state government matter, proponents of further deregulation consider that the Australian Government should take a greater role in encouraging change in this area. The Australian National Retailers Association (sub. 16, p. 4) has asked that:

> The Federal Government initiates and drives States to reform retail trading hours towards a nationally harmonised regime that delivers unrestricted trading on all days with the exception of Good Friday, ANZAC Day morning and Christmas Day.

Restrictions on delivery times can hinder the efficiency of logistics networks

Some retailers and retail industry associations also contend that restrictions on delivery times to their stores (because of local government attempts to control excessive noise near residential districts) compromise the effectiveness and efficiency of their transport logistics systems, and therefore drive up costs.

> The operational efficiency and cost effectiveness of retailers logistics networks are diminished by key State-based restrictions on the time of transportation, and the type of transportation (allowed) by local council regulation (Coles, sub. 7, p. 13)

The issue of allowable delivery times is likely to become even more complicated if 'mixed' developments — for example, combined retail/residential developments — become more popular (such developments offer advantages to retailers, including more flexible zoning and proximity to customers). In their submission to this study the Shopping Centre Council of Australia (SCCA) noted that the Brisbane City Council's draft new City Plan encourages mixed use development, but proposes restrictions on shopping centre delivery times to the hours 6 am to 7 pm. The SCCA (sub. 17, p. 12) notes that this:

> (would) be in conflict with another one of Council's desired outcomes for an '18 hour economy' as part of encouraging a vibrant city.

In this case, the challenge for local governments is how to manage the trade-offs between the benefits of having an '18 hour economy' and the congestion, noise and other costs associated with the extended shopping centre delivery times necessary for such an economy to operate efficiently.

INFORMATION REQUEST 4.2

How can state and local governments most efficiently accommodate the interests of both retailers and residents in mixed developments in relation to noise and other issues (congestion and safety for example)?

Rising power and water charges are a concern

The cost of utilities is a smaller component of total retail business costs compared with labour and occupancy costs. However, large increases in electricity, gas and water charges over the past five years have added to the overall cost pressures faced by retailers.

Submissions to this study have highlighted a number of issues in relation to the costs retailers face for utilities services, including the general level of energy prices, Government energy policies such the Renewable Energy Target (RET) and the Carbon Tax, differential pricing of electricity across customers, and economically inefficient water delivery charges:

> Electricity is a significant input into many Australian businesses. It represents an unavoidable cost of doing business due to our reliance on energy to produce goods and services for the domestic market and export. Maintaining our competitive advantage in low cost energy is an important strategic economic and business goal for government. (Swimming Pool And Spa Alliance, sub. 5, p. 8)
>
> There is an increasing awareness of the environmental issues and costs in the marketplace and this has translated into a focus towards energy management to reduce costs of operation for retailers. There have been an increasing number of businesses looking to solar power and energy efficient light fittings to reduce running costs as well as smart technology for management of these systems in use. The LFRA expects this trend to continue in the immediate future. (Large Format Retail Association, sub. 19, p. 7)
>
> … the introduction of the Carbon tax and the ongoing operation of the renewable energy target (RET) have added significant pressure to businesses.
>
> The Government should examine the true impact of the RET on business and employment. And to work with the states to maximise efficiency of the electricity supply chain – reducing real costs for businesses and consumers and providing a long term boost to the retail sector. (National Retail Association, sub. 18, pp. 8–9)
>
> We have an example where in Edgewater Shopping Centre the independent liquor store pays 22% more for electricity to run their lighting and refrigeration verses the supermarket in the same centre. … We believe this to be a case of anticompetitive price discrimination that is no longer covered by Competition Law in Australia … The fact is anticompetitive price discrimination is now rife in the grocery sector … (Western Australian Independent Grocers Association, sub. 2, p. 4)
>
> SA Water bases its water pricing on the capital value of land rather than actual water usage (although this is presently being reviewed). (Shopping Centre Council of Australia, sub. 17, p. 9)

Freight costs are also a concern

Australia's population dispersion and distance from major overseas markets necessitates an efficient, reliable and modally integrated freight transport system.According to the Supply Chain & Logistics Association of Australia (SCLAA) (sub. 15, p. 1):

> One of the fastest growing costs for retail businesses in Australia, especially small – medium retail business is freight. This includes freight costs from supplier to the retailer and from the retailer to the consumer, where for example goods are shipped to the consumer.

Coles (sub. 7, p. 3) has also raised concerns regarding the transport cost increases they expect to face if pay rates for transport drivers are increased by the Road Safety Remuneration Tribunal (RSRT) as part of their ongoing inquiry into pay rates in the road transport and distribution industry.

The SCLAA (sub. 15, p. 1) raises a particular concern about increases in postal charges for parcels and satchels:

> Australia Post has increased the prices of Parcel Post satchels (500g and 3kg) by 55% since 2009. They have also increased the prices of over the counter parcels and Express Post satchels, by a similar amount. … As you know, the Australian Bureau of Statistics CPI increase, given the Australian and Global economy in the past 4 years has been approximately 11.07% since 2009. Therefore Australia Post has increased prices five times the CPI.

INFORMATION REQUEST 4.3

To what extent are retail sector costs adversely affected by changes to the pay rates of heavy vehicle transport drivers, and by other transport and freight cost issues?

Inconsistent and costly product labelling and packaging and food safety laws

In relation to product labelling and packaging and food safety laws, submissions to this study (and to the 2011 Commission review of the retail sector) have raised concerns about the general cost of achieving regulatory compliance, and the cost burden of inconsistencies in regulatory compliance and enforcement:

> Prior to the importation of a single helmet, an importer of helmets into Australia must pay a fee of $21 025 + GST to meet current Australian Standards requirements, with each model incurring further costs. …
>
> A further variable cost incurred is the design costs to modify helmets to meet Australian Standards. As Australia has the strictest helmet standards in the world, further engineering costs are incurred in most instances to modify the helmet to meet these standards. Due to the current standards, introduced in 2008, the majority of helmets constructed for European and American markets do not pass Australian testing protocols. (Bicycle Industries Australia, sub. 8, p. 7)

> The retail sector is littered with examples of packaging and signage requirements which at best can only be described as unnecessary red tape. … Some states go so far as to stipulate the font and size of in-store sign-writing, but these requirements vary, creating significant administrative expense for businesses. … [Similarly] the laws governing product technical and safety standards are a tangle of bureaucratic red tape. In many cases products that are approved for sale in one state are banned in others. (National Retail Association, sub. 18, pp. 9-10)

Woolworths (sub. 13) has provided evidence of the cost to them of enforcing a Victorian regulation that prohibits the sale of plastic knives to minors, despite the likelihood that enforcing the ban arguably does not make the community any safer than it would otherwise be (box 4.3).

Another concern is the subjective and unpredictable interpretation of regulations, sometimes within the same jurisdiction and involving the same regulatory officer (Coles, sub. 7).

Box 4.3 One example of anomalous regulations – the ban on sales of plastic knives to minors in Victoria

In March 2010, the Premier of Victoria announced amendments to the *Control of Weapons Act 1990* (Vic) giving police new powers to search for weapons and banning minors (under the age of 18) from purchasing 'controlled weapons', including kitchen knives and plastic knives. These amendments were passed by the Victorian Parliament in August 2010. As a result of these amendments, from 1 January 2011:

- minors face an on the spot fine of $239 for buying knives, including plastic picnic knives, and a possible court appearance and fine of up to $1433
- retailers face a fine of up to $2389 for selling knives to minors.

These fines are enforceable despite the fact that minors can readily access the same types of plastic knives from takeaway food outlets next door to retailers.

Retailers have to ensure customers are over 18 when they purchase plastic knives. This means transactions have to be suspended to check customers' identification. This is more time consuming at self-service checkouts. Woolworths (sub. 13, p. 5) has estimated that across its supermarkets this ban increases its costs by $128 000 per year. Woolworths noted that no other state or territory defined a plastic knife as a controlled weapon.

On 8 January 2014, the Acting Premier and Treasurer of Victoria announced 36 'red tape reforms' following consultations with businesses by the Victorian Red Tape Commissioner. These 36 reforms included lifting the ban on the sale of plastic knives to minors. The Commission understands that legislation will be introduced shortly in the Victorian Parliament to that effect. In late 2013 Victoria Police advised the Victorian Government that pending an amendment to lift the restriction on the sale of disposable plastic knives to juveniles, police will not prosecute retailers in the interim. What is unclear is whether retailers have been advised of the policy.

Sources: Victoria Police (nd); Woolworths (sub. 13), Department of Justice, Victoria, pers. comm., 2 June 2014.

The proposal to introduce front of package labelling for food products will also likely raise costs to retailers, albeit with potential benefits to consumers in the form of better information regarding product content. Coles (sub. 7, p. 4) has questioned, however, the basis on which the decision to introduce the new labelling system was made:

> The introduction of the Health Star [labelling] will cost industry $200 million, with some costs likely to flow through to customers. … a Regulatory Impact Statement … was not prepared for consultation or the decision …

Another regulatory driver of retail sector costs is quarantine or other controls over the interstate movement of goods. Examples of the latter include restrictions on shipping potatoes into Western Australia, restrictions on rice that can be imported and sold in Australia's principal rice growing districts, and additional packaging and treatment requirements applying to a range of products before they can be commercially imported into Tasmania.

While there may be important biosecurity issues that ultimately justify the additional costs that these restriction place on retailers, it is important that these controls are regularly reviewed to ensure that the benefits continue to exceed the costs.

Beyond the policy and regulatory issues raised above, submissions to this study have highlighted a range of other regulatory issues that impact on the costs of doing business, including council rates, and other taxes and charges (box 4.4).

Box 4.4 **Participants' views on other regulations**

Swimming Pool And Spa Alliance (sub. 5):

> Compliance costs for retailers that operate nationally or in more than one state create an enormous financial burden on businesses by asking them to replicate processes which include unnecessary costs, administrative tasks, resources and sizeable and unnecessary delays. (p. 10)

Coles (sub. 7):

> From a regulatory perspective, the biggest challenge to efficiencies in the retail trade industry is the cumulative impact of regulatory red tape and the inconsistent adoption of regulation in different jurisdictions. (p. 3)
>
> Planning systems and development consent conditions vary between States and Local Governments, each with different focuses on factors such as design, noise, signs, trading hours/delivery hours, trolley managements etc. (p. 16)

(Continued next page)

Box 4.4 (continued)

> Container Deposit Schemes exist in South Australia and (pending) in the Northern Territory with other States reportedly considering their options. A wider CDS would … add at least $300 to an average shopping basket per annum … (p. 7)
>
> Local government is responsible for the administration and enforcement of much legislation enacted by State and Federal Authorities. However, … As there is no coordinating system for determining precedent, different jurisdictions will often apply the same rules in different ways. (p. 16)

Australian National Retailers Association (sub. 16):

> Research by PricewaterhouseCoopers (2011) shows Australian retailers face a high number of taxes when compared to other Australian industry groups. (p. 15)

Gilmour's (sub. 11):

> Workers' Compensation arrangements in the separate States also vary, and again there is no uniformity in the type of reporting required for each state. (p. 6)

Woolworths (sub. 13):

> Cost imposed by fees and charges … land tax, council rates and service charges in South Australia are relatively high compared to other jurisdictions. … For a parcel of land valued at $20 million, the tax payable in South Australia is over $700 000. Victoria would levy just over $400 000 while Western Australia would levy less than $300 000. (p. 6)

Shopping Centre Council of Australia (sub. 17):

> A large cost burden for retail property owners, and therefore retailers, is as a direct result of Government imposed taxes. … At an industry level, we allocate significant resources in seeking to minimise a range of 'outgoings' such as land valuation issued by the Valuer-General, land tax, council rates, water charges and electricity regulation. (p. 8)
>
> Council rates have become a major area of concern in recent years mainly due to the invention by Australia's local councils of dubious reasons to impose higher rates on shopping centres … . Although state governments have broad powers in relation to local government they often don't intervene on specific issues and we are therefore left in the hands of an irrational council which will gladly increase commercial property rates in order to maintain lower residential rates. (p. 9)
>
> By an accident of history, shopping centre owners and managers are also subject to real estate agent regulation which varies from state to state and imposes significant extra costs on the industry. … this is costing the shopping centre industry around $6 million per annum around Australia. (p. 21)

INFORMATION REQUEST 4.4

In relation to all of the policy and regulatory drivers of retail sector costs under consideration in this study, the Commission is seeking further input and advice from stakeholders to help prioritise those areas where the prospects for achieving meaningful reforms are greatest, and where the potential cost savings and productivity improvements are also expected to be large compared with the costs of reform.

4.4 Policy levers influencing the cost of goods

As noted in the introduction to this interim report, the cost of goods is not within the scope of this study. However, the Commission notes that government tax policy is also a key driver of the cost of goods in retailing. For example, tariffs and parallel importation arrangements artificially inflate domestic retailers' costs through, for example, the import duties paid, compliance arrangements, and higher prices resulting from price discrimination. The Commission has examined these issues extensively in the past, drawing attention to the net gains available from key reforms (see, for example, PC (2011a) and PC (2009)).

In this study retailers and retail sector analysts have suggested that since the Commission's 2011 inquiry report on the Australian retail industry, retailers have been increasingly importing directly and effectively going around the parallel import arrangements. We note that parallel import restrictions are being examined as part of the ongoing review of competition policy.

The Commission continues to report on the effective cost of tariffs through its Trade and Assistance Reviews. Over time the relative cost to GDP has been declining but compared to some other cost elements noted in this study tariffs are not insignificant. A review of the Australian taxation system would provide an opportunity for the Government to reconsider the net costs to business and consumers of tariffs, including the compliance costs to business and consumers arising from complex rules of origin, and the revenue trade-offs required with the removal of tariffs.

5 Progress since 2011

Key points

- The Commission's 2011 inquiry report on the economic structure and performance of the Australian retail industry made a number of recommendations to improve retail sector productivity and retailers' capacity to respond to consumer preferences.
- Many issues raised in this study were also raised in that inquiry. However Governments' progress to address these costly anticompetitive provisions has generally been slow and patchy and participants have generally been critical of the overall lack of reform since 2011. Stakeholders recognise that a significant number of the recommendations are matters for the states and territories and highlight the gains in employment and economic activity and cost reduction that could be achieved through individual jurisdiction's reforms.
- All jurisdictions have initiated reform processes but few have achieved substantial reform — Victoria stands out as the exception across the various areas identified by the Commission although the reforms are incomplete. In some cases, reform processes have progressed to consultation and review stages but no further. In the case of trading hours reforms in New South Wales, legislation was blocked in the Legislative Council.
- While some attempts to implement the Commission's recommendations have been made, the pace of reform differs materially across jurisdictions and significant regulatory inconsistencies remain. Key issues identified by participants are:
  - planning and zoning. There are some signs of partial progress on planning and zoning in some jurisdictions with Victoria leading the way
  - penalty rates, relatively high wages and labour on-costs and rigidities as a result of awards under the Fair Work Act
  - the low value GST threshold
  - inconsistent local and state-based regulation. In relation to trading hours, while there has been some relaxation of restrictions, four jurisdictions are yet to fully deregulate their trading hours. South Australia introduced changes in 2012 but these have entrenched inconsistent regulation within that state.
- Although jurisdictions had agreed to reform and harmonise a range of generic regulation (such as that for occupational health and safety and transport) and regulation making and review processes, in many cases reforms have been partial or remain incomplete.
- Current and proposed reviews at the Commonwealth and state level — notably the current review of competition policy and the forthcoming review of workplace relations — provide further opportunities to identify regulatory issues that affect competition and productivity in the broader economy.

A number of the issues raised in this study were raised by participants in the Commission's 2011 inquiry into the Economic Structure and Performance of the Australian Retail Industry. In that inquiry the Commission found that Australia's retail industry faced challenges to operating in an increasingly competitive environment. These challenges included new sources of competition, such as online retailing, and regulatory restrictions that hindered retailers' ability to compete and innovate.

In 2011, the Commission made a number of recommendations aimed at improving retail sector productivity and retailers' capacity to respond to consumer preferences. This chapter updates the progress of the Commission's recommendations, drawing on information provided by all jurisdictions, submissions and publicly available information.

While some progress has been made on most of the recommendations, participants in the study have been critical of the pace of reform and the concerns evident in the 2011 inquiry remain (box 5.1).

5.1 Online retailing

Monitoring online retailing (Australian Government)

The Commission's 2011 report found that online retailing was growing rapidly, but that there was little hard evidence of the extent of online retailing in Australia. The Commission (2011a) recommended:

> The ABS should monitor and report online expenditure both domestically and overseas by Australian consumers. The ABS should also consider options that will enable the disaggregation of online spending and employment associated with 'multi-channel' establishments and 'pure-play' online retailers (recommendation 4.1).

In response, the Australian Government noted the recommendation and stated that the ABS would continue to develop its surveys to ensure they capture emerging trends in retail spending, having regard to budgetary implications and competing priorities.

In August 2013, the ABS released an information paper on measuring online retail trade which detailed where online retail trade activity is captured in ABS macroeconomic statistics (2013e). Since March 2013 the ABS has produced experimental estimates of the value of turnover from domestic online retail sales, disaggregated between 'multi-channel' and 'pure-play' online retail trade activity.

Box 5.1 **Participants' views on progress on the Commission's 2011 recommendations**

Progress has been made in a small number of areas but overall the pace of implementation has been generally disappointingly slow. In fairness to the current and former Federal Governments, many of the recommendations made by the Productivity Commission in 2011 would need to be implemented by State and/or Territory Governments. This makes it difficult — but not impossible — for the Federal Government to push the reform agenda forward. (Australian National Retailers Association, sub. 16, p. 4)

From a regulatory perspective, the biggest challenge to efficiencies in the retail trade industry is the cumulative impact of regulatory red tape and the inconsistent adoption of regulation in different jurisdictions. This imposes a significant administrative and financial burden on our business and ultimately on our customers. (Coles, sub. 7, p. 1)

Neither [federal] government has seriously addressed the recommendations in the 2011 PC Report. In particular, while the ABS is now reporting on online shopping, the low value threshold has not been scrapped or reduced, despite several further reports into the issue and a significant increase in online consumption by Australians in the past three years. (Australian Sporting Goods Association, sub. 10, p. 3)

… we note that there are still few or no noticeable changes to … either the Bulky Goods or GST anomalies or the data collection mess. (Gilmours Pty Ltd, sub. 11, p. 1)

Planning and zoning issues in some states have improved, as have retail trading hours, but more work could still be done in these areas. (Australian Retailers Association, sub. 14, p. 5)

The most comprehensive pursuit of [planning and zoning] recommendations was the Victorian Government's zoning reforms which commenced in 2013 … even in the case of Victoria's reforms … it could be interpreted that it inadvertently picked winners and hasn't fully enabled competitive neutrality. (Shopping Centre Council of Australia, sub. 17, pp. 13-14)

Despite the extensive re-working of the planning system and consultation process associated with the reforms, the [New South Wales] Government has not been able to have the new legislation passed through the Legislative Council. Several amendments were proposed by the Legislative Council but these include watering down the Code and as-of-right processes and so the Government has not accepted them. (Australia National Retailers Association, sub. 16, p. 9)

The WA Economic Regulation Authority has recently issued a draft report into micro-economic reform opportunities that recommended the liberalisation of trading hours in WA. If this reform is adopted, Woolworths alone would create hundreds of additional jobs and there would be many more across the entire retail sector. (Woolworths, sub. 13, p. 3)

In 2013 the Queensland Competition Authority … recommended liberalising retail trading hours in Queensland. This report found that the net potential benefit to Queensland of removing the current restrictions was $200 million per annum … the Queensland Government has not yet acted on this recommendation. (Woolworths, sub. 13, p. 4)

The Fair Work legislation continues to remain a concern as it assumes a 'one size fits all' approach to industrial relations whilst imposing unnecessary cost burdens on businesses and limited work choices to employees. (Swimming Pool and Spa Alliance, sub. 5, p. 6)

The Productivity Commission in 2008 recommended a voluntary code of conduct, enforceable by the ACCC, to replace retail tenancy legislation for shopping centre leases … This recommendation has been ignored by all governments. (Shopping Centre Council of Australia, sub. 17, p. 16)

In October 2013, the ABS released a technical note detailing its methodology to estimate the value of goods imported under the low value threshold (LVT) (2013d). These estimates form the basis of adjustments which have been implemented in relevant ABS macroeconomic publications from the September quarter 2013.

Low value GST threshold (Australian, state and territory governments)

In 2011, the Commission found that the LVT of $1000, below which imports are generally not subject to indirect taxes, fees and charges, distorts consumer choice in favour of online retailers. The Commission (2011a) recommended:

> There are strong in-principle grounds for the low value threshold (LVT) exemption for GST and duty on imported goods to be lowered significantly, to promote tax neutrality with domestic sales. However, the Government should not proceed to lower the LVT unless it can be demonstrated that it is cost effective to do so. The cost of raising the additional revenue should be at least broadly comparable to the cost of raising other taxes, and ideally the efficiency gains from reducing the non-neutrality should outweigh the additional costs of revenue collection (recommendation 7.1).
>
> The Government should establish a taskforce charged with investigating new approaches to the processing of low value imported parcels, particularly those in the international mail stream, and recommending a new process which would deliver significant improvements and efficiencies in handling. The taskforce should comprise independent members, with the Australian Customs and Border Protection Service (Customs), the Australian Quarantine and Inspection Service (AQIS), Australia Post and the Conference of Asia Pacific Express Carriers providing advice. The terms of reference should outline the criteria that any new system must satisfy including: minimising the costs of processing and delivery delays, streamlining the assessment of Customs Duty, user pays, and without compromise to the border protection functions of Customs and AQIS. This review should report to Government in 2012 and propose an expeditious timeframe for its proposed changes.
>
> Once an improved international parcels process has been designed, the Australian Government should reassess the extent to which the LVT could be lowered while still remaining effective (recommendation 7.2).

The Australian Government noted recommendation 7.1 and agreed to recommendation 7.2, and advised that it would establish a Low Value Parcel Processing Taskforce to provide a blueprint for reform of the low value import processing system, with costed alternatives, for the Government’s consideration.

The Taskforce reported in July 2012 and recommended an approach to handling and administering low value goods, including revenue implications, however due to data limitations advised that this did not constitute a business case (Low Value Parcel Processing Taskforce 2012). In its interim response to the Taskforce’s report in December 2012, the Australian Government advised that further work on business cases, costings and implementation plans was required before any decision on changing the LVT (Australian Government 2012). In November 2013, the Australian Government Treasurer commissioned a working group of state and Commonwealth Treasuries to finalise proposals for lowering the threshold (Baird 2013). In May 2014, the New South Wales Treasurer stated that jurisdictions were evaluating a business case to lower the threshold (Bita 2014).

The Commission has been advised that there is no public statement regarding the timetable for consideration of the threshold.

5.2 Retail-specific regulation

Parallel import restrictions (Australian Government)

The Commission’s 2011 report identified that copyright laws can be used to prevent the resale of parallel imported goods in certain circumstances. The Commission (2011a) recommended:

> The Australian Government should request the Australian Law Reform Commission, as part of its forthcoming Copyright Inquiry, to examine whether the costs to the community outweigh the benefits in relation to the parallel import restrictions in the Copyright Act 1968, which prevent retailers from importing and selling clothes or other goods which embody decorative graphic images sold with the copyright owner’s permission in another market (recommendation 6.1).

The Australian Government did not adopt the Commission’s recommendation and instead stated that it would consider the matter and explore further options. The issue is being examined in the ongoing Australian Government Competition Policy Review which is due to report by December 2014 (Competition Policy Review 2014a).

Retail tenancy leases (Australian, state and territory governments)

In 2008, the Commission’s inquiry into the market for retail tenancy leases in Australia found that retail tenancy legislation, which aims to address bargaining imbalances between large shopping centre landlords and small retailers, was highly prescriptive and had grown in volume. There were also significant and widening differences between jurisdictions, despite efforts at harmonisation, and aspects of the legislation had constrained the market, lowered productivity and added to compliance and administrative costs. The Commission recommended a nationally consistent retail lease framework to increase efficiency and reduce costs.

In its 2011 inquiry, the Commission found that retail tenancy legislation had not been successful in improving the adversarial nature of the relationship between landlords and tenants in shopping centres and the more extreme negotiating tactics could be moderated through a voluntary national code of conduct for shopping centre leases, as had been recommended by the Commission in 2008. The Commission (2011a) recommended:

> COAG should ensure that all current National Retail Tenancy Working Group projects are fully implemented. It should also re-examine the outstanding recommendations from the Commission's 2008 retail tenancy report with a view to expanding the work plan of the National Retail Tenancy Working Group (recommendation 9.1).

The Australian Government agreed in-principle with the Commission's recommendation, noting that retail tenancy issues are primarily the responsibility of state and territory governments.

Victoria made a number of changes to its retail tenancy legislation and regulations in 2012 and 2013, including removing some reporting obligations for landlords (Department of State Development, Business and Innovation, pers. comm., 12 May 2014). In March 2013, Victoria also announced a working group to consider the feasibility of introducing a Victorian retail lease register (Department of State Development, Business and Innovation, pers. comm., 12 May 2014).

While New South Wales is currently reviewing its retail lease legislation it is also developing a standard lease for New South Wales that landlords can use voluntarily, and an online disclosure statement for landlords and retailers (Office of the Small Business Commissioner New South Wales, pers. comm., 12 May 2014).

In Western Australia, amendments to commercial tenancy laws, including changes to disclosure statements and relocation clauses, commenced on 1 January 2013 (Department of Commerce nd). Queensland and the Northern Territory have reviewed their legislation. The Northern Territory is in the process of amending its business tenancies legislation (Department of the Chief Minister, pers. comms., 22 and 23 May 2014). There appears to be no public commitment to respond to Queensland's review by a particular date.

The National Retail Tenancy Working Group was established in 2008 under COAG's Small Business Ministerial Council to improve transparency and consistency between state and territory retail tenancy regulation (PC 2011a). In 2012, The National Retail Tenancy Working Group was disbanded after it was unable to achieve national harmonisation on a number of key retail tenancy issues (Small Business Development Corporation (Western Australia), sub. 9).

The issue is within the scope of the ongoing Australian Government Competition Policy Review which is due to report by December 2014 (Competition Policy Review 2014b).

Retail trading hours (Australian, state and territory governments)

In 2011, the Commission found that restrictions on trading hours applied with varying levels of intensity, with Queensland, Western Australia and South Australia having the most restrictive regulations. The Commission (2011a) recommended:

> Retail trading hours should be fully deregulated in all states (including on public holidays) (recommendation 10.1).

In its response, the Australian Government noted the recommendation, stating that retail trading hours were primarily the responsibility of the state and territory governments. The Australian Government stated that National Competition Policy (NCP) provided a process for the states and territories to review and reform legislation restricting competition, and that as part of NCP, the Commonwealth had implemented measures to encourage the deregulation of retail trading hours.

Victoria, Tasmania, the ACT and the Northern Territory have already deregulated (or effectively deregulated) their trading hours.

New South Wales attempted deregulation in 2012 but the legislation was withdrawn as it did not have the support of the Legislative Council (Parliament of New South Wales nd).

Trading hours are most restricted in Queensland, Western Australia and South Australia and are inconsistent within these jurisdictions.

In Queensland, extended trading hours for some retailers vary depending on locality (Office of Fair and Safe Work Queensland 2013). In 2013, the Queensland Competition Authority found that deregulation would deliver a net benefit of $200 million a year (Queensland Competition Authority 2013). However, statements by the Queensland Government suggest further reform is unlikely (Atfield 2013). Although Western Australia's trading hours were partially liberalised between 2009 and 2012 (Department of Commerce, pers. comm., 5 May 2014), significant restrictions remain outside the Perth metropolitan area. In April 2014 the draft report of the Economic Regulation Authority of Western Australia's inquiry into Microeconomic Reform in Western Australia recommended effectively full deregulation (ERAWA 2014).

South Australia extended its shop trading hours in 2012, but restricted the changes to Adelaide's central business district to:

> [ensure] that Adelaide is a vibrant central meeting place for the South Australian Community and for visitors to our State, while at the same time balancing the opportunities for workers to spend time with family and friends on special days of commemoration and celebration. (Wortley 2012).

This had the effect of entrenching the difference in trading hours within the state.

Participants in this study advised that trading hours reform remains a priority (box 5.2). While this is an issue for state and territory governments, it is within the scope of the ongoing Australian Government Competition Policy Review which is due to report by December 2014 (Competition Policy Review 2014b).

Box 5.2 **Trading restrictions**

Study participants raised trading hours as a priority for reform as it continued to constrain economic activity and consumer choice in some jurisdictions. While Victoria, Tasmania, the ACT and the Northern Territory have already deregulated (or effectively deregulated) trading hours, participants advised that inconsistent regulation within and across other jurisdictions arbitrarily reduces trading activity.

Participants provided evidence of the benefits of reform. For example, Woolworths stated that:

> In 2012 limited Sunday trading was introduced in the Perth metropolitan area. This small reform has been a success with Woolworths publicly predicting that it would hire 700 additional staff as a result. This prediction has been met and the new positions have been created across the Woolworths group … (sub. 13, p. 3)

The restrictions were also seen as unnecessarily reducing the capacity to meet consumer demand, particularly in an environment where consumers are tending to prefer smaller and more frequent purchasing, and the contestability of markets has increased due to the growth of online retailing.

Even where trading hours have been liberalised, efficiency gains can be unwound by other restrictions prescribing when particular goods can be sold (chapter 4).

Source: Woolworths (sub. 13).

5.3 Other regulations

Workplace relations (Australian Government)

In 2011, the Commission found that effective competition in those sectors of Australia's retail industry exposed to international competition required labour productivity that did more than keep pace with future wage movements. While the Commission's 2011 report suggested that there could be scope to improve workplace regulation to enhance workplace flexibility and adaptability, any examination of workplace relations needed to go beyond the retail industry (PC 2011a).

The Commission (2011a) recommended:

> The Australian Government should, within the context of the current system and consistent with the maintenance of minimum safety net provisions for all employees, examine retail employer and employee concerns about the operation of the Fair Work Act. This should include consideration of options to address any significant obstacles to the efficient negotiation of enterprise-based arrangements, that have the potential to improve overall productivity. The post-implementation review of the Fair Work Act, which is to commence before 1 January 2012, should provide the appropriate review mechanism. This review should be comprehensive, transparent, provide adequate time and opportunity to receive and consider input from all stakeholders, and be conducted independently.
>
> The first review of modern awards by Fair Work Australia, scheduled for 2012, is a further opportunity to address concerns that relate specifically to the operation of relevant retail awards. This review should also provide adequate opportunity for input from all relevant stakeholders (recommendation 11.1).

The Australian Government noted the recommendation and stated that concerns about the Fair Work Act could be examined in the post-implementation review to the extent they fell within the scope of the review. The Australian Government anticipated the 2012 transitional review and ongoing reviews of modern awards would provide the retail industry with the opportunity to have its issues addressed.

The report of the post-implementation review of the Fair Work Act was released on 2 August 2012 (Department of Employment nd). Legislation to implement recommendations, including changes to unfair dismissal provisions and the functions of the Fair Work Commission, was passed by Parliament in December 2012. Further recommendations, including the introduction of family friendly arrangements and requirements to consult about changes to regular rosters and work hours, were legislated in June 2013 (Shorten 2013).

On 27 February 2014, the Australian Government introduced amendments to the Fair Work Act on a number of outstanding recommendations including changes to individual flexibility arrangements governing when work is performed, overtime and penalty rates (Fair Work Amendment Bill 2014). The Bill was referred to the Senate Education and Employment Legislation Committee on 6 March 2014 and the Committee was asked to report by 5 June 2014. The Explanatory Memorandum to the Bill also anticipated that the proposed amendments would be reviewed as part of the Productivity Commission's forthcoming review of the workplace relations framework, which is scheduled to commence in 2014 (Abetz 2014).

The Fair Work Commission considered penalty rates and junior rates in the 2012 interim review of modern awards (Lander & Rogers 2013) (Fair Work Commission 2014). The Fair Work Commission commenced the four-yearly review of modern awards in January 2014 (Fair Work Commission nd).

Planning and zoning (Australian, state and territory governments)

The Commission previously undertook a study into Australia's system of planning and zoning, and conducted performance benchmarking of state and territory processes (PC 2011b). Based on the Development Assessment Forum leading practice model — which all states and territories endorsed in 2005 — jurisdictions were assessed on their progress towards leading practice.

In its 2011 retail inquiry (and based on its assessment from the planning and zoning study), the Commission found that planning and zoning regulations were 'complex, excessively prescriptive and often anticompetitive' (PC 2011a, p. XIV). The Commission (2011a) recommended:

> State, territory and local governments should (where responsible) broaden business zoning and significantly reduce prescriptive planning requirements to allow the location of all retail formats in existing business zones to ensure that competition is not needlessly restricted. In the longer term, most business types (retail or otherwise) should be able to locate in the one business zone (recommendation 8.1).
>
> Governments should not consider the viability of existing businesses at any stage of planning, rezoning or development assessment processes. Impacts of possible future retail locations on existing activity centre viability (but not specific businesses) should only be considered during strategic plan preparation or major review — not for site specific rezoning or individual development applications (recommendation 8.2).
>
> State, territory and local governments should facilitate more as-of-right development processes to reduce business uncertainty and remove the scope for gaming by competitors (recommendation 8.3).
>
> State and territory governments should ensure third party appeal processes within planning systems include clear identification of appellants and their grounds for appeal

and allow courts and tribunals to award costs against parties found to be appealing for purposes other than planning concerns (recommendation 8.4).

State, territory and local governments should reduce the compliance costs associated with planning systems and development approvals by implementing the leading practices identified in the Commission's recent benchmarking report on planning, zoning and development assessments (recommendation 8.5).

In response, the Australian Government agreed with the recommendations in principle and encouraged the states and territories to carefully consider and implement the Commission's findings.

Victoria is more advanced in adopting planning and zoning reforms than other jurisdictions (box 5.3), although the implementation of aspects of reform attracted criticism on competitive neutrality grounds. Despite the reforms in business zoning, there are areas of reform identified by the Commission in its 2011 inquiry report that remain incomplete — there has been no change to third party planning appeal processes, for example.

Box 5.3 **Recent planning and zoning reforms in Victoria**

In its 2011 inquiry, the Commission recommended that business zoning be broadened to allow all retail formats in existing business zones, with a longer term goal that most business types (retail or otherwise) be permitted in the one business zone.

In 2013, the Victorian Government undertook reforms aimed at improving business zones and permissible uses. It was announced that the prevailing five business zones were to be condensed into two broader commercial zones. The reform was to have the effect of increasing permissible uses within the zones, thereby bypassing the need for often lengthy (and costly) rezoning processes. Benefits of the reform included:

- more mixed uses and diversity within employment precincts
- making the property sector more responsive to changes in demand for various business types/models
- removing planning barriers to investment.

Sources: Department of Transport, Planning and Local Infrastructure (Vic) (2013), Office of the Minister for Planning, pers. comm., 14 May 2014.

A number of jurisdictions are still in the process of reviewing their planning systems, but the impacts and outcomes from those processes are less certain. As stated by the Large Format Retail Association (LFRA), '[t]here has been a trend towards review of planning regulation however the only review to date that has resulted in positive changes is in Victoria' (sub. 19, p. 9).

In the ACT, since at least 2011, the planning authority cannot consider existing business viability in planning processes. Business zones and permissible uses have not been broadened, and floor restrictions remain, particularly for shops and supermarkets. Under planning legislation, third party appellants are not required to identify themselves or their grounds of appeal, however competition issues are not a legitimate ground to commence appeal proceedings. Courts cannot award costs under planning legislation.

In the Northern Territory, since at least 2011, the planning authority cannot consider the viability of existing businesses in planning processes, and third party appeal processes are available in limited circumstances.

Table 5.1 provides a brief summary of some of the planning and zoning changes that states have introduced since the Commission's 2011 inquiry report. It also provides information provided by LFRA, which has commented on the progress of reform against the Commission's recommendations for all states.

The Commission welcomes further details from the states and territories on their progress against the 2011 PC recommendations, and the Commission invites comments on stakeholders' views on the performance of individual states and territories, as well as the impediments to progress, and how they can be addressed.

In its response to the Commission's 2011 inquiry report, the Australian Government also said it would establish the Retail Council of Australia comprising key industry stakeholders to provide a forum for industry to raise its concerns with the Government. The Retail Council held its third meeting in June 2013 (Bradbury 2013). However, the Shop Distributive and Allied Employees' Association (sub. 6) informed the Commission that the Council has not met since.

Planning and zoning issues are being examined in the ongoing Australian Government Competition Policy Review which is due to report by December 2014 (Competition Policy Review 2014a).

Table 5.1 A brief summary of some state planning and zoning changes since 2011, and LFRA[a] comments on reform

State	*Progress on implementing recommendations and comment from the LFRA on reform*
NSW	**Progress:** Reviewed its planning regime between 2011–13 and legislation was introduced on 22 October 2013, some of which is still currently before the Parliament. **LFRA comment:** 'The existing planning system was considered to be outdated; overly complex and time consuming and needed to be completely overhauled in order to attract investment in the state to meet the population growth forecasts. The New South Wales Government has undertaken an extensive and exhaustive process of more than two and a half (2.5) years to consult with stakeholders … In December 2013 this entire process reached an impasse in the parliament due to political opposition. It currently remains unclear as to whether the Government will continue to introduce new legislation or revert to the existing system without further change.'
Vic	**Progress:** Broadened its zoning provisions in 2013, but there has been no significant change to third party planning appeals processes. **LFRA comment:** 'In July 2013, the Victorian Government implemented changes to the Victorian Planning Provisions by reforming the State's planning zones … These recent zoning changes in Victoria have created the most flexible planning system for retail development in Australia. The changes are a reduction in the amount of regulation and involve the removal of restrictions while creating an increase in the supply of land for retail development and use. These changes are entirely consistent with the recommendations of the Productivity Commission and should serve as a model for other States and Territories to follow.'
Qld	**Progress:** facilitative as-of-right development processes, but still considers existing business viability. **LFRA comment:** 'Following some 18 months of consultation and debate, the Queensland Government is working to create new legislation to implement a new planning framework for the State … The proposed changes to the Queensland planning system are also based on principles consistent with the Productivity Commission recommendations. The LFRA is encouraged by the recent progress and direction of planning reform in Queensland.'
WA	**Progress:** Commenced a review of the planning system in 2009, and starting in late 2013, is currently in the process of considering adopting track based assessments. **LFRA comment:** In 2013 the Western Australian Department of Planning undertook a review of the Model Scheme Text (MST) which provides standard land use term definitions for use by Councils across the State … This review has not produced an outcome and has in effect stalled or has been placed on hold … In summary, there has been no substantial change in Western Australia for many years now despite the existence of various planning reviews being undertaken. The LFRA is concerned about the future of planning in the State and its ability to identify and implement changes necessary to streamline and integrate the planning system.'
SA	**Progress:** Broadened business zoning in 2011, but floor restrictions remain. Third party appeal processes were previously assessed as leading practice and are unchanged. **LFRA comment:** 'In February 2013 the State Government appointed a panel of experts to review the current planning system in South Australia; consult widely with the community and all stakeholders and make recommendations for the introduction of a new planning system for the State. The project is entitled think-design-deliver and is due for issue of its final report at the end of December 2014 … [T]he LFRA is concerned that there will be an increase in red tape as a result of the review.'
Tas	**Progress:** In early 2014, planning zones were significantly reduced, and a taskforce is currently being assembled to develop standard documents and procedures for applications and permits. **LFRA comment:** Tasmania is currently in a state of *'planning reform'* with a number of key outcomes achieved and processes in place … Under the recently elected new State Government, Tasmania is heading in the right direction of a uniform state planning system which is consistent with other States and again consistent with the Productivity Commission recommendations in 2011.'

[a] LFRA = Large Format Retail Association (sub. 19).

Sources: CIE (2013); Department of Planning and Local Government (SA) (2011); Department of State Development, Infrastructure and Planning (Qld) (2013); Department of State Development, Infrastructure and Planning (Qld), pers. comm., 29 May 2014; Department of Transport, Planning and Local Infrastructure (Vic) (2013); Department of Treasury and Finance (Tas), pers. comm., 2 May 2014; Gold Coast City Council (2011); Large Format Retail Association (sub. 19); PC (2011b); Planning Administration Bill 2013 (NSW); Planning Bill 2013 (NSW); Tasmanian Liberals (2014); Western Australian Planning Commission (2013).

Other regulatory burdens (Australian, state and territory governments)

The Commission's 2011 inquiry identified concerns about regulation that hindered the retail industry's ability to respond efficiently to consumer preferences, including:

- retail specific and generic regulation
- inconsistent regulation across jurisdictions
- registration and licensing obligations
- inadequate regulatory impact analysis.

Several of these had been examined in previous Commission reports or review processes.

The Commission (2011a) recommended:

> Governments must prioritise efforts directed at the review and reform of existing regulations that are unnecessarily burdensome, and reduce regulatory inconsistency across jurisdictions where that affords net benefits to business and the community. Consideration also needs to be given to how existing quality control processes for new or amended regulation, including the application of Regulation Impact Statement processes, can be improved to minimise the risk that future regulation will impose unnecessary burdens (recommendation 13.1).

The Government agreed with the recommendation in-principle, and stated that it would progress reform across jurisdictions through COAG and task the Commission to review, benchmark and report on regulatory issues. In some cases these recommendations were to utilise existing reform platforms through legislation review and COAG.

In 2008 COAG agreed to reform and harmonise a range of generic regulation, pursue competition reform in priority areas and develop and enhance processes for regulation making and review through a National Partnership Agreement to Deliver a Seamless National Economy. COAG progressed reforms to varying degrees between 2008 and 2013 in areas including occupational health and safety (OHS), environmental assessment, food regulation, payroll tax and chemicals and plastics. In some cases these processes were completed (although implementation was not complete) and others were assessed as partially complete or not complete (COAG Reform Council 2013).

In its final report on progress with the National Seamless Economy Reforms the COAG Reform Council (2013) reported that:

- national uniform OHS laws had not been fully achieved — Victoria and Western Australia had not enacted laws while New South Wales, Queensland, South Australia and the ACT had laws which differed from the model national law
- after five years, chemicals and plastics reforms were only partially complete
- while most governments had completed regulation and review milestones, this had not directly improved regulation making and review procedures.

In December 2013, COAG announced that in the future it would focus on a few important national priorities and that improving productivity would be a major ongoing focus. On deregulation, COAG stated that it would work on reducing red tape in manufacturing, higher education, early childhood and ‘end-to-end’ regulation of small business (COAG 2013).

Since 2011, the Commission has assessed the impact of 17 COAG reforms (PC 2012b), benchmarked regulatory impact analysis (PC 2012c) and assessed the burden of regulation on small business (PC 2013) (box 5.4).

Victoria is to map regulatory requirements imposed on small businesses in exporting and food manufacturing and has developed online forms to reduce business red tape (Small Business Victoria, pers. comm., 12 May 2014).

The Northern Territory has announced that the Civil and Administrative Tribunal will provide retailers with a one-stop-shop for access to dispute resolution facilities and a red tape business advocate as an interface between business and government (Department of the Chief Minister, pers. comm., 21 May 2014).

Box 5.4 Previous Commission reports on regulatory burdens

In 2012, the Commission assessed the extent to which federal, state and territory regulatory impact analysis processes ensure that policy development delivered regulation that provided the greatest net benefits to the community. The Commission found that existing processes fell short of agreed principles due to exemptions, shortcomings in consultation and a lack of transparency and accountability around revisions to proposals and the basis for decisions . The Commission proposed that jurisdictions could improve the efficacy and rigour of regulatory impact assessments through greater transparency, accountability and better commitment to the process.

In 2012 the Commission also assessed the impacts and benefits of 17 business regulation reforms including to standard business reporting, product safety, consumer law and consumer credit, payroll tax, occupational health and safety and food. These reforms were agreed to by jurisdictions under the Council of Australian Governments' National Partnership Agreement to Deliver a Seamless National Economy, which aimed to reduce the regulatory burden on firms operating in multiple jurisdictions. While the Commission assessed that there was the potential for reform to raise output and income in all jurisdictions, for firms that do not operate across state boundaries the gains from harmonisation could be eroded where additional transition and ongoing costs of reform exceeded the benefits. Overall, the Commission estimated the economy-wide benefits of fully implementing the reforms to be almost half a per cent a year in increased output and around $4 billion a year in lower business costs. The majority of gains could accrue by 2020.

In 2013, the Commission benchmarked regulators' approaches to dealing with small businesses, to improve regulator delivery of objectives and reduce unnecessary business compliance costs. The Commission recommended a range of improvements to regulation design, resourcing, compliance obligations, enforcement responses and communication practices.

Sources: PC (2012b), PC (2012c) PC (2013).

INFORMATION REQUEST 5.1

How have governments progressed against the 2011 Productivity Commission recommendations?

INFORMATION REQUEST 5.2

What has been the impact of reforms to retail-specific and generic regulation to date? Where the pace of reform has lagged, what are the barriers to reform and how could these be overcome?

- *To what extent could these barriers be attributed to the reform process?*

- *Where these barriers are considered sufficient to jeopardise the prospect of reform, what other approaches could provide net benefits to the community?*

INFORMATION REQUEST 5.3

What impact has the lack of consistency in the pace of reform between jurisdictions had on the costs of doing business in the retail sector?

Nationally harmonised regulation can bring substantial national benefits, but they can also impose disproportionate costs on smaller businesses, particularly those operating in one state.

- *What are the advantages and disadvantages for businesses operating across state borders of opt-in harmonised arrangements — with the existing state regulations being the default?*
- *Would a two-tiered opt-in system impose undue regulatory burdens on small businesses and/or government administration?*

INFORMATION REQUEST 5.4

What examples are there of reforms that are considered 'leading practice' that should be adopted more broadly?

INFORMATION REQUEST 5.5

What are the anticipated benefits and costs of specific reforms for individual businesses, the retail industry and the community?

A Public consultation

In keeping with its standard practice, the Commission has actively encouraged public participation in this study.

Following receipt of the terms of reference on 7 April 2014, the Commission placed an advertisement in a national newspaper and sent a circular to identified interested parties.

The Commission released an issues paper on 11 April 2014 to assist those wishing to make written submissions. Nineteen written submissions were subsequently received and are listed in table A.1.

As detailed in table A.2, the Commission met with a wide range of stakeholders. These included government departments, companies, industry associations, research centres, and market analysts.

The Commission also wishes to acknowledge the contributions of various federal and state government agencies who provided supplementary information to assist the Commission in preparing its interim report. The agencies who contributed in this manner are listed in table A.3.

The Commission thanks all those who have contributed to this study and now seeks additional input towards its final report. The Commission welcomes further submissions to discuss the substance of the interim report, including responses to the information requests.

Table A.1 **Submissions received**

Participant	*Submission No*
Australian National Retailers Association	16
Australian Retailers Association	14
Australian Sporting Goods Association	10
Bicycle Industries Australia	8
City of Melbourne	3
Coles	7
Frontline Hobbies	4
Gilmour’s	11
Large Format Retail Association	19
Margetts, Dr Diane (Dee)	1
National Retail Association	18
The Pharmacy Guild of Australia	12
Shop, Distributive and Allied Employees’ Association	6
Shopping Centre Council of Australia	17
Small Business Development Corporation	9
Supply Chain & Logistics Association of Australia	15
Swimming Pool and Spa Alliance	5
Western Australian Independent Grocers Association	2
Woolworths	13

Table A.2 **Meetings**

Participants
ALDI
Australian Centre for Retail Studies, Monash University
Australian National Retailers Association
Australian Retailers Association
Bunnings and Officeworks
Citi
Coles
Costco
Council of Small Business of Australia
Department of the Prime Minister and Cabinet
Ernst and Young
KPMG
Reserve Bank of Australia
Shopping Centre Council of Australia
Stockland
The Treasury
UBS
Westfield
Woolworths

Table A.3 **Supplementary information received**

Participants
Attorney-General's Department
Australian Bureau of Statistics
Department of Business, Northern Territory
Department of Commerce, Western Australia
Department of Lands, Planning and the Environment, Northern Territory
Department of Planning, Transport and Infrastructure, South Australia
Department of Planning, Western Australia
Department of State Development, Infrastructure and Planning, Queensland
Department of State Development, Business and Innovation, Victoria
Department of Treasury and Finance, Tasmania
Environment and Sustainable Development Directorate, Australian Capital Territory
NSW Industrial Relations
Office of the Minister for Planning, Victoria
Office of the Small Business Commissioner, New South Wales

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