

Clubs Queensland

**Response to Productivity
Commission Draft Report on
Australia's Gambling
Industries**

October 1999

Contents

| | | |
|----------|--|-----------|
| 1 | Introduction | 1 |
| 1.1 | Purpose | 1 |
| 1.2 | Background | 1 |
| 2 | The economic and social benefits of the Club Industry in Queensland | 3 |
| 2.1 | Introduction | 3 |
| 2.2 | Economic benefits of Clubs in Queensland | 3 |
| 2.3 | Social benefits associated with the Club Industry | 7 |
| 3 | Responsible Gaming in the Queensland Club Industry | 9 |
| 4 | Chapter 20 – Principle of Mutuality | 12 |
| 4.1 | Introduction | 12 |
| 4.2 | The key elements and assertions | 12 |
| 4.3 | Policy Options | 13 |
| 4.4 | Response to the key elements, assertions and recommendations | 14 |
| 4.5 | Suggested policy responses – Chapter 20 | 49 |
| 5 | Summary of conclusions and recommendations | 54 |

1 Introduction

1.1 Purpose

The purpose of this document is to outline the views of the Queensland Club Industry in response to the Productivity Commission Inquiry's Draft Report on Australia's Gambling Industries. This submission covers three key areas of concern:

- Economic and social benefits of the Queensland Club Industry;
- Responsible service of gaming in the Queensland Club Industry; and
- Issues arising from Chapter 20 of the Productivity Commission's Draft Report – The Mutuality Principle.

1.2 Background

Clubs Queensland is the industry association and union of employers for all registered and licensed clubs in Queensland and acts as the representative body with government, statutory and regulatory authorities on all matters affecting clubs.

Registered and Licensed Clubs are community-based associations established with the purpose of providing sporting, cultural, recreational and community services to their members and the local community in which they are based. The vast majority of members of Clubs Queensland are incorporated under the *Associations Incorporation Act 1981* and exist for the benefit of their members. All net proceeds from their operations are expended on the provision of facilities and services to their members and the local community. No individual or group of individuals is able to derive personal profit from the operations of a Club, except under normal commercial arrangements for provision of goods and services.

The annual reports of all Clubs with gaming machines are provided each year to the Queensland Department of Fair Trading and Equity and the Office of Gaming Regulation (OGR), for assessment as to whether the Club has expended the income derived from gaming on the Objects of the Club as stated in its Constitution. Both regulatory authorities have the power to investigate the operations of a Club if evidence warrants such action.

Since the introduction of gaming machines to Queensland Clubs in 1992, a significant proportion of the licensed Clubs in Queensland have installed machines. As at December 1998, Queensland has approximately 1,100 licensed Clubs (with a liquor licence of some nature) of which 656 have gaming machines. (*Source: Liquor Licensing Division and QOGR Gaming Newsletter, Vol 2, Issue 1, March 1999*)

These Clubs now rely, to some extent, on the revenue from gaming machines to fund other operations and community service activities. Accordingly, licensed Clubs represent a component of the wider gambling industry, however they should not be considered in the same context as other sectors of the gambling industry, due to the community ownership of Clubs.

2 The economic and social benefits of the Club Industry in Queensland

2.1 Introduction

Clubs Queensland commissioned KPMG Consulting to undertake an independent assessment of the economic and social benefits associated with the Club Industry in Queensland in June 1999. A full text copy of the report is provided to the Commission for its reference. Clubs Queensland believes that the Productivity Commission's Draft Report gave little regard to the benefits of the Clubs Industry to the Queensland economy and community and as such, some of the key findings from this report are included below.

2.2 Economic benefits of Clubs in Queensland

The Productivity Commission of Inquiry's Draft Report has estimated that the benefits to consumers from gambling were between \$5.4 and \$6.3 billion in 1997/98. Based on the findings of the KPMG report, Clubs Queensland believes that the Commission's estimates are conservative as the total contribution by the Queensland Club Industry alone to the Gross State Product in 1998 was estimated to be \$1.2 billion.

Accordingly, for every \$1 spent in Licensed Clubs in Queensland on gaming, food and beverage, entertainment, membership and other activities, approximately \$1.23 is generated in the Queensland economy in terms of Gross State Product (or economic "value added").

Licensed clubs contribute to the employment of Queenslanders. In particular, clubs are significant employers of young workers, female employees and first-time employees. KPMG estimated that up to 18,000 people work in licensed clubs for wages and salaries. This workforce amounts to one in five of all the jobs in the sports and recreation sector.

There are thousands of other jobs created in the wholesale, retail and service sectors supplying an increasing array of goods and services to Clubs throughout the State.

The KPMG economic impact assessment found that approximately 23,000 full-time equivalent jobs are generated both directly and indirectly throughout the State due to the Licensed Club Industry activities.

Also, clubs have invested over \$350 million in new and refurbished buildings in the past five years, creating thousands of additional jobs in the building industry and in the services sector and suppliers of furniture and materials.

The KPMG survey of licensed clubs undertaken as part of their assessment indicated that, for a sample of 171 licensed clubs, a construction program worth approximately \$170 million up to 2004 is either already committed or in the planning stage. Many of the redevelopment and refurbishment programs have been master-planned with input from the members who will ultimately benefit from the facilities and services provided.

The expansion in the range and quality of facilities provided by Clubs has boosted our tourism income as Clubs cater for the needs of thousands of interstate and international tourists each month.

As Clubs are community-owned entities delivering services and facilities to assist local communities, community service obligations are taken very seriously.

All net income derived from Club activities is returned to the members of Clubs and their local communities through better facilities, provision of sporting and recreational services and financial support to community welfare organisations.

The State and Federal tax revenues from Clubs have been of some significance in addressing the range of economic and social policies and programs of each level of Government.

During 1997/98, approximately \$133 million of the net gaming machine revenue of \$453 million was returned to the State Government in the form of taxes and levies, a large proportion of which was returned to the general community through transfers to charities and sporting groups.

In addition to payments of taxes and levies, the Licensed Club Industry is estimated to provide approximately \$35 million in cash support per year to sporting groups, charities and welfare organisations and the general public. On top of this, the Licensed Club Industry is estimated to provide in-kind support equivalent to approximately \$44 million per annum.

Total support to the community from gaming as measured by taxes, levies, cash donations and sponsorships and in-kind donations and sponsorships, is therefore estimated to be approximately 47% of the total gaming machine net metered win in Queensland in 1998 as shown below:

| | | |
|--|---------------|------|
| Net metered win in Qld Clubs 1998 | \$453 million | 100% |
| * Gaming machine taxes (consolidated revenue) | \$74 million | 16% |
| *+ Sports and Recreation Fund | \$30 million | 7% |
| * Community Benefit Fund | \$11 million | 2% |
| *+ Charities and Rehabilitation Fund | \$18 million | 4% |
| Cash donations and sponsorships | \$35 million | 8% |
| In-kind donations and sponsorships ('profit foregone') | \$44 million | 10% |

* Based on a notional distribution of gaming machine funds collected.

+ Also includes some minor amounts received as State-wide Keno taxes.

By way of an example of the types of contributions that may be made by clubs to local community undertakings, we have included a case example of the financial support provided by Kedron Wavell Services Club to local sporting and community facilities in 1998.

| Case example | 1998 contributions |
|--|---|
| <p>Kedron Wavell Services Club is a clubs that is at the forefront of the industry when it comes to contributing to its local community through discretionary contributions. The following specific community projects were initiated by the Club:</p> | |
| <i>Chernside swimming pool and library</i> | |
| <p>In 1994, Kedron Wavell Services Club worked with the Brisbane City Council to develop the precinct surrounding the Club. The development plan included the redevelopment of the Chernside Swimming Pool and the construction of a new library. The Club will also fund the development of a synthetic hockey field, at Burntongbar Park at the rear of the Club.</p> | |
| <p>The Club has agreed to contribute \$7.6 million in periodic payments from 1995 to 2005 for the development of the area in addition to a further \$800,000 for the development of adjoining hockey fields.</p> | |
| <p>Assessed contributions to the project in 1998 totalled \$1.0 million:</p> | \$1,000,000 |
| <i>Shaw Park sporting fields (Shawsports)</i> | |
| <p>Kedron Wavell Services Club acquired the lease of Shaw Park, a 32 hectare sporting complex and parkland, during 1998 and immediately implemented a five year plan to upgrade the facilities and support the sports which use the venue. Since acquiring the lease, the Club has built four cricket pitches, completed earthworks to improve access, developed better parking and spectator facilities and installed improved lighting. The Club also provided staff to operate the sporting and licensed facilities at Shaw Park.</p> | |
| <p>Kedron Wavell Services Club has agreed to contribute a total of \$4.0 million to Shaw Park over the next five years. In 1998, the Club spent \$466,890 on the venue:</p> | \$467,000 |
| <i>Additional projects</i> | |
| <p>Kedron Wavell contributed the following monetary and in-kind support to community ventures and activities during 1998:</p> | |
| <p>Sponsorship of community and sporting groups:</p> | |
| <p>Donations:</p> | |
| <p>Total contributions 1998</p> | \$316,000 \$44,000 <hr/> \$1,827,000 |
| <p>It acknowledged and noted that Kedron Wavell Services Club is one Queensland's premier clubs and its level of community contribution, in total dollar terms, is possibly the highest of any club in the State. Accordingly, this case example is not intended to represent the "typical" club, but is included to gauge the level of contributions possible for larger clubs in Queensland.</p> | |
| <p>Source: Kedron Wavell Services Club</p> | |

2.3 Social benefits associated with the Club Industry

Because of the 'family' nature of Clubs, they provide safe, comfortable and affordable venues for socialising and entertaining of many people who would otherwise be isolated in their own homes, such as older widows and disabled adults.

Clubs have an obligation to the welfare of their members and tend to be more responsive to the welfare and best interests of members. They do not wish to engage in activities, which could be harmful to the best interests of their community.

Club board structures ensure that the direction of and focus of Club activities is strongly community focussed. They operate a balance between professional management and the community focus of the board.

Clubs provide an organisational structure for people to achieve a sense of belonging to a group and work together to achieve improvements and benefits for their families, neighbours and other community members.

The building of function facilities and meeting areas establishes community centres which act as a focal point in the community for activities and functions and clubs utilise the income from their gaming operations for the provision of sporting facilities and services, especially for junior players.

The income generated by Clubs enables them to offer a range of community services directly to their members such as sub clubs within clubs, e.g. billiards, bowling, leagues, darts and golf clubs, education and training programs, recreation amenities and activities.

As well clubs provide their facilities for training and work experience programs and build close relationships with schools, TAFE Colleges and other training providers.

In 1998, Clubs Queensland commissioned CMP Marketing Services, an independent research and marketing firm, to undertake a major primary market research project to determine the perception and attitudes of the general public and community sectors to licensed clubs. The research program surveyed included surveys of 1,713 members of the general public and 100 community groups. The results were published in September 1999. Full text copies of the survey results are attached for the Commission's reference.

The survey of 100 community groups found that the significant majority of respondents strongly agree with the statements:

- Clubs provide a safe environment for socialising and entertainment;
- Clubs provide vital employment and tourism opportunities in local communities;
- Clubs are vital for the provision of local sports; and
- Clubs care about their local community.

In addition, the survey of 1,713 members of the general public showed that:

- 82% of respondents agreed to the proposition that the Club Industry is vital for providing funding for and the provision of local sport.
- 76% of respondents agreed that that clubs cared about their local communities.
- 87% of respondents agreed with the proposition that clubs provide vital employment and tourism opportunities in local economies.
- 86% of respondents agreed that clubs provide a safe environment for socialising.

The same survey found that almost two thirds of respondents nominated meals/dining as main reason for visiting clubs, followed by socialising, use sporting facilities. Fourth was to play gaming machines.

In summary, Clubs Queensland wishes to emphasise to the Commission that there are substantial tangible and intangible benefits provided by the Club Industry to the Queensland economy and community. This is highlighted by the research data provided to the Commission, namely, the KPMG economic social and economic impact assessment and the CMP Marketing research.

3 Responsible Gaming in the Queensland Club Industry

The Productivity Commissions Draft Report has stated that 2.3% of Australian adults and 2.5% of Queensland adults may be “problem gamblers”. Clubs Queensland acknowledges that there is a small percentage of the population that may be considered to have a problem with gambling, and in particular, playing gaming machines. However, it is important to note that the Licensed Club Industry has not only recognised this for many years, but has also been addressing this issue through the development of a comprehensive Responsible Gaming Policy (currently in draft form).

It is also important to point out that the vast majority of people who do gamble do not have a problem.

The Commission's own figures state that over 80% of Australians gambled last year. That means that 97% of those Australians who did gamble did so responsibly.

What is disappointing is that the Commission's draft report takes a negative or “glass 2.3% empty” attitude. This merely plays into the hands of the media who mostly glance through the executive summary and extract the negative statements from the report.

What should be highlighted is that clubs are pro-active in helping those people with gambling problems and are very responsible in the service of gaming.

Clubs in Queensland currently have internal policies for the Responsible Service of Gaming, including ensuring staff complete recognised training courses.

Clubs Queensland conducts a four-hour training workshop for all its members in the provision of Responsible Gaming Services. This course deals with the skills and knowledge required to assist problem gamblers and offers assistance and advice to those customers.

The workshop covers:

- identification and assistance to potential problem gamblers;
- provision of assistance to family and friends;

- process and procedures for ensuring referral to counselling agencies is dealt with correctly and sensitively explained to family and friends;
- formal procedures for barring a customer from gambling; and
- procedures to be followed if the bar is broken.

Apart from displaying the "Rules Ancillary to Gaming" as per the *Gaming Machine Act 1991*, Clubs provide signage in their venues detailing the names and phone numbers for:

- Gamblers Anonymous;
- Salvation Army; and
- Lifeline and other such groups.

Many Clubs provide pamphlets and brochures to Club members regarding Responsible Gambling.

This year Clubs Queensland has been developing a Draft Responsible Gaming Policy for the club industry. This process has included all clubs throughout the state and is intended for use by Queensland clubs, including their board members, managers and staff where they operate under a gaming licence.

The Policy includes a Club Code of Practice for Responsible Gaming.

After final consultation with all clubs throughout the state, Clubs Queensland will be providing a copy of this policy to relevant stakeholders in Queensland and also to the Productivity Commission.

A trial programme of this draft policy and code will be implemented on a three month trial basis. On receipt of feedback the policy will be refined and presented to the state and federal governments for review, comment and subsequent endorsement.

It is imperative that the responsible service of gaming in Clubs be self-regulated. If forced legislation were to be enacted rather than establishing industry-owned best-practice for issues regarding gaming control, minimum compliance would be provided by clubs. Because of the nature and structure of clubs, the Club Industry is best placed to know the requirements of regulation in this area.

It is far better for all to follow the current path where the Club Industry is adopting a responsible pro-active approach to gaming. This approach includes the presentation of a workable policy underpinned by a Club Code of Practice, which is accepted and applied by all members and addresses potential gambling problems, particularly those associated with gaming machines.

Clubs in Queensland will continue to demonstrate an ongoing commitment to the responsible service of gaming with regular reviews of the policy, the Code of Practice and its associated programmes, documentation and activities.

In summary, Clubs Queensland acknowledges that there is a small percentage of the population that may not gamble responsibly. The Association submits that the best way to provide the responsible service of gaming to all club patrons is by industry-owned, self-regulation.

4 Chapter 20 – Principle of Mutuality

4.1 Introduction

Chapter 20 of the Draft Report on Australia's Gambling Industries, produced by the Productivity Commission, addresses the issue of the mutuality principle as it relates to the taxation of income derived by clubs in Australia. In Chapter 20, the Productivity Commission acknowledges the important role of clubs in Australian communities (p.20.2) and proceeds to critique the industry in terms of equity, efficiency and social considerations. However, the Commission appears to favour measures that would see the elimination or dilution of the principle of mutuality and consequently, result in a reduction in the ability of clubs throughout Australia to provide the community benefits acknowledged in the draft report.

The Commission makes a number of assertions regarding the club industry in Chapter 20, which underpin its conclusions and recommended policy considerations. This section of the report identifies the significant assertions adopted by the Commission with regard to the club industry.

4.2 The key elements and assertions

Chapter 20 of the Productivity Commission Draft Report makes a number of key assertions and representations. Clubs Queensland wishes to respond to the following elements of Chapter 20:

- The sample of clubs examined and represented in Chapter 20 to make key assertions and recommendations are not representative of clubs generally, either in Australia, NSW or Queensland;
- Clubs have expanded their operations to include other non-core activities and as a result, have lost their mutual character;
- Clubs engage in below market pricing and cross-subsidisation in bar, catering and other activities as a result of the combination of the principle of mutuality and access to gaming machines. The Commission contends that members possibly receive economic income from being a member of a club through receiving services at prices lower than those charged by commercial enterprises. It is then concluded that if this can be shown to be the case, then this would provide in-principle rationale for some taxation of mutual income;

- Clubs can offer better odds for gaming machines because they can take advantage of economies of scale arising from access to greater numbers of machines;
- The Commission concludes that if clubs engage in wide-spread and consistent setting of prices at below-market levels (compared with comparable “commercial” operations), then this is an inefficient outcome in that capital is being allocated on non-commercial grounds. The basis of this assertion is the Commission’s acceptance of the view that clubs’ level of pre-tax return is at below market levels;
- The Commission’s request to quantify the level of community contributions from clubs;
- The Commission’s suggestion that tax foregone by governments as a result of the principle of mutuality may be better in the hands of government rather than clubs, on the assumption that governments allocate funds more equitably; and
- The governance issues raised by the Commission. The Commission suggests that governance arrangements at clubs may be weaker than those at most private commercial businesses.

4.3 Policy Options

Based on the key findings and assertions flowing from the analysis outlined in Chapter 20, the Productivity Commission suggests and considers the following policy options:

- Tax poker machine surpluses by quarantining them from mutuality;
- Change the structure of the industry so that gaming machines revenues are earned on a commission basis;
- Increase state taxes on poker machine revenue;
- Place lower ceiling limits on the number of machines in clubs; and
- De-mutualise larger clubs.

The Commission prefers the imposition of higher State taxes and seeks views on the feasibility and social and economic impacts of this and other options for change.

4.4 Response to the key elements, assertions and recommendations

4.4.1 Club profile and their expansion into other commercial operations

4.4.1.1 Introduction

The draft report from the Productivity Commission focuses on the NSW licensed club market and, in particular, a small, unrepresentative sample of major clubs in the NSW market. While the Commission acknowledges that not all clubs have the same character and profile as the larger clubs in NSW, very few references are made to the Queensland club market. Clubs Queensland is of the opinion that the Productivity Commission focuses too heavily on a very small sector of the Club environment in Australia and fails to properly acknowledge the fundamental differences between the regulatory and market conditions for licensed clubs in NSW and other Australian jurisdictions. The Productivity Commission draws significant conclusions and policy options based on a cursory analysis of a sample of atypical clubs. Clubs Queensland contends that:

- It is incorrect and misleading to focus on this minor sector of the market;
- Any policy directions and options based on conclusions drawn from examination of such a small sector of the overall club environment will be flawed;
- It would be fundamentally inequitable to adopt blanket policies for the Australian club environment based on such a narrow analysis.

This section of our submission provides evidence to support the contentions that:

- The sample of clubs analysed in the draft report does not represent the NSW club market;
- The Queensland Club market is fundamentally different to the NSW market; and
- Clubs in Queensland have not lost their "mutual character" and continue to maintain a community focus.

4.4.1.2 *The sample of clubs examined by the Productivity Commission*

The Productivity Commission stated (p.20.9) that it examined annual reports of 28 clubs in NSW. However, the draft report presents data on 20 clubs only. The following table lists the clubs presented in the draft report, the number of poker machine license for each venue and each club's ranking in terms of total machine net revenue for three months from 1 December 1998 to 28 February 1999:

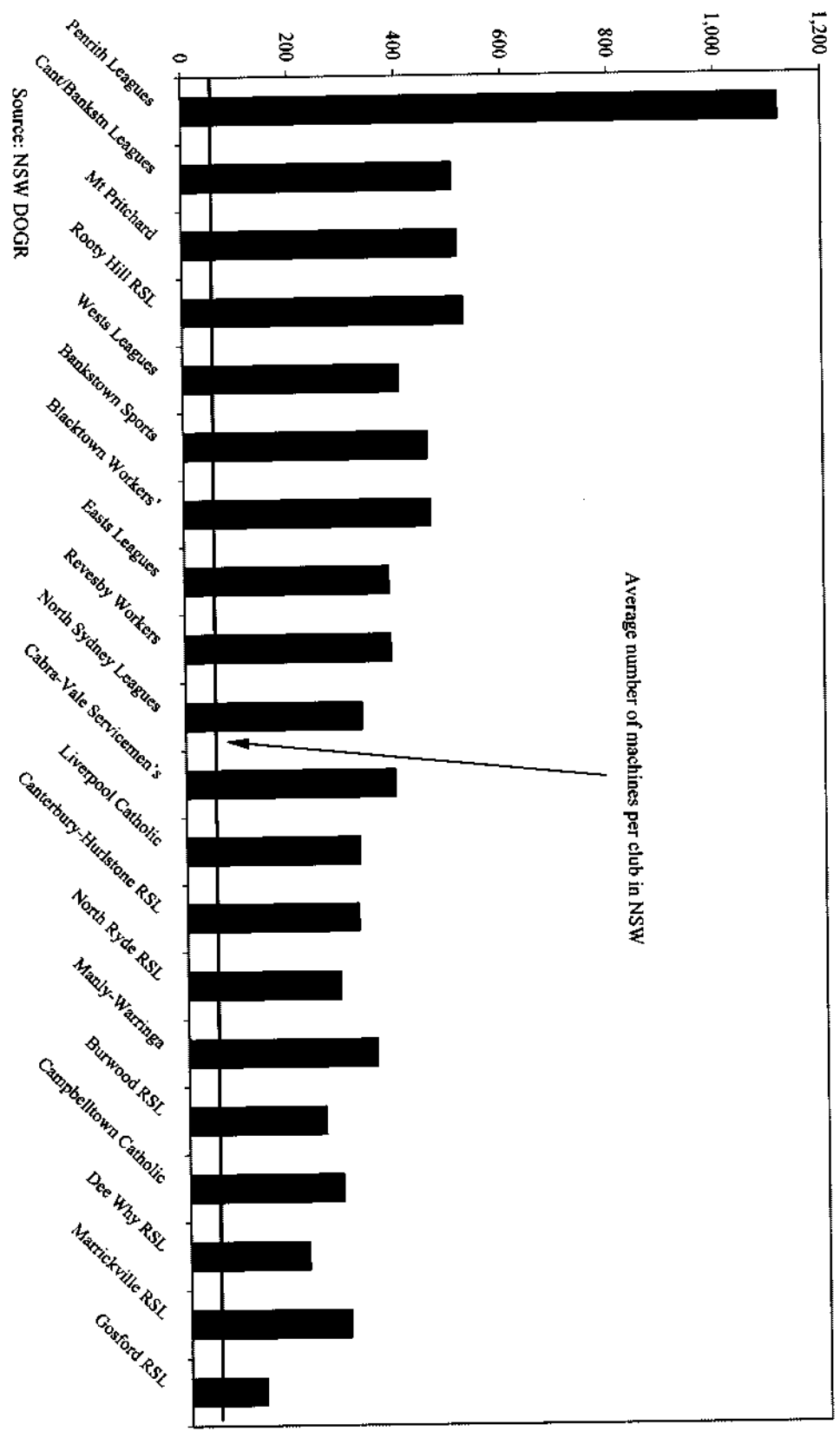
| Sample of Licensed Clubs Presented in Productivity Commission Draft Report Gaming Machine Net Revenue Ranking and Number of Gaming Machines For three months 1 December 1998 to 28 February 1999 | | |
|--|--------------------------------------|-------------------|
| Club Name | Number Machines as at February 98 | Ranking in Sydney |
| Pentith Rugby League Club | 1,119 | 1 |
| Canterbury-Bankstown League Club | 506 | 2 |
| Rooy Hill RSL Club | 527 | 6 |
| Mt Pritchard & District Community Club | 515 | 4 |
| Bankstown District Sports Club | 457 | 10 |
| North Sydney Leagues Club | 331 | 15 |
| Eastern Suburbs Leagues Club | 383 | 13 |
| Blacktown Workers' Club Limited | 462 | 12 |
| Cabra-Vale Ex-Active Servicemen's Club | 393 | 16 |
| Revesby Workers Club | 386 | 14 |
| Western Suburbs Leagues Club | 405 | 9 |
| Canterbury-Hurlstone Park RSL Club | 322 | 18 |
| Manly-Warringa Rugby League Club | 354 | 22 |
| Liverpool Catholic Club | 325 | 17 |
| Campbelltown Catholic Club | 288 | 26 |
| North Ryde RSL Club | 287 | 20 |
| Dee Why RSL Club | 223 | 27 |
| Marrickville RSL Club | 300 | 43 |
| Burwood RSL Club | 257 | 23 |
| Gosford RSL Club | 140 | 77 |
| Total machines for sample | 7,980 | |
| Total machines in clubs in NSW | 71,795 | |
| Sample percentage machines in NSW | 11.1% | |
| Average number of machines per sample club | 399 | |
| Average number of machines in NSW clubs Feb 1999 | 50 | |

Source: NSW Department of Gaming and Racing

The sample of clubs analysed by the Productivity Commission is clearly unrepresentative of the population of clubs in NSW and for Australia as a whole. In particular:

- All clubs analysed and presented are based in the Sydney Statistical Division. No club from regional NSW was presented. As at 28 February 1999, 38,807 machines were installed in clubs within the Sydney Statistical Division, representing 54% of the total number of machines in clubs throughout NSW;
- 14 of the 20 clubs assessed were ranked in the top 20 Sydney clubs for the February 1999 Quarter in terms of gaming machine revenue. 19 of the 20 were ranked in the top 50 and all were ranked in the top 80; and
- The average number of gaming machines for each site presented in the analysis was 399, compared with the NSW State average as at February 1999 of 50 machines. The average number of machines per club in Queensland as at March 1999 was 28 and, according to the Australian Bureau of Statistics (cat. 8687.0), for the 1997/98 year, the average number of gaming machines for all clubs across Australia (clubs with machines only) was 40 per club. The following chart demonstrates the divergence between the sample of clubs examined by the Commission and the average number of machines at clubs in NSW as a whole.

Number Machines as at February 1999



The Productivity Commission Draft Report also presented some financial data on the sample of clubs reviewed in Chapter 20. The following table summarises the key information presented in Chapter 20 for the sample of clubs:

| Sample of Licensed Clubs Presented in Productivity Commission Draft Report | | | |
|--|---|--|--|
| Club Name | Reported profit before income tax and Gaming Machine Net Profit | | |
| | Total revenue \$000 | Gaming machine net revenue \$000 | Operating profit before income tax \$000 |
| Penrith Rugby League Club | Not reported | Not reported | 573 |
| Canterbury-Bankstown League Club | 42,577 | 37,340 | 6,846 |
| Rooty Hill RSL Club | Not reported | Not reported | 6,682 |
| Mt Pritchard & District Community Club | Not reported | Not reported | 6,686 |
| Bankstown District Sports Club | Not reported | Not reported | 4,069 |
| North Sydney Leagues Club | 25,173 | 20,956 | 4,017 |
| Eastern Suburbs Leagues Club | 25,385 | 18,397 | 2,472 |
| Blacktown Workers' Club Limited | 31,705 | 20,410 | 1,896 |
| Cabra-Vale Ex-Active Servicemen's Club | 25,087 | 20,167 | 5,341 |
| Revesby Workers Club | 24,394 | 16,042 | 1,120 |
| Western Suburbs Leagues Club | 22,078 | 17,331 | 3,009 |
| Canterbury-Hurlstone Park RSL Club | 22,319 | 16,620 | 1,598 |
| Manly-Warringa Rugby League Club | 20,696 | 16,005 | 2,562 |
| Liverpool Catholic Club | 22,540 | 15,197 | 2,632 |
| Campbell Town Catholic Club | Not reported | Not reported | 4,009 |
| North Ryde RSL Club | Not reported | Not reported | 3,018 |
| Marrickville RSL Club | 15,569 | 13,338 | 661 |
| Dee Why RSL Club | 16,594 | 13,459 | Not reported |
| Burwood RSL Club | 16,104 | 11,951 | 2,223 |
| Gosford RSL Club | Not reported | Not reported | 648 |
| Sample average \$ million | 23.9 | 18.2 | 3.2 |
| Average for NSW Clubs (with gaming) 1997/98 \$ million | *2.8 | **1.7 | ***0.26 |
| Source: Productivity Commission Draft Report July 1999 | | | |
| * ABS cat 8670 | | | |
| ** DOGR 1997/98 | | | |
| *** application of average profit level all clubs ABS cat 8670 | | | |

- The Productivity Commission's selected sample of clubs were reported to have achieved average annual revenues of between \$42.6 million and \$15.6 million. The sample average was \$23.9 million. However, according to the Australian Bureau of Statistics' 1997/98 analysis of clubs, taverns and bars, the average level of revenue per club in NSW was reported to be \$2.8 million or less than 12% of the sample average;
- The sample of clubs in the Productivity Commission's Draft Report was reported to have achieved between \$37.3 million and \$11.9 million in gaming machine net revenues with a sample average of \$18.2 million. According to the NSW Department of Gaming and Racing report of gaming for the 1997/98 year (ended 31 May 1998), 1,418 clubs earned a total of \$2,378 million in gaming machine net revenue or \$1.68 million per club. The average level of gaming machine revenue for NSW clubs was less than 5% of the average for the sample clubs selected by the Productivity Commission in its analysis; and
- According to the Australian Bureau of Statistics' 1997/98 analysis of clubs, taverns and bars, clubs throughout Australia, with gaming facilities, achieved a profit level, before income tax, of 9.4% in 1997/98 on average. Applying this earnings percentage level to the average revenue for clubs in NSW, we estimate that the average pre-tax earnings per clubs in 1997/98 was approximately \$260,000, compared with the sample average of \$3.2 million.

To further illustrate the contention that the sample of clubs is not representative of the NSW market generally, we have examined distribution of gaming machines and gaming machine net revenue for clubs as at February 1999. The following information is a summary analysis of published information from the NSW Department of Gaming and Racing.

| Distribution of gaming machines and net revenue in NSW Clubs For the Quarter ended 28 February 1999 | | | | | | |
|--|-------|---------------------------|----------|--------------------------|--------------------------------|-----------------------------|
| Gaming machine range | Clubs | Cumulative % all clubs | Machines | Cumulative % machines | Gaming machine net revenue \$m | Cumulative % net revenue |
| 10 and less | 299 | 21% | 2,265 | 3% | 4.5 | 1% |
| 10 to 20 | 386 | 48% | 5,754 | 11% | 21.4 | 4% |
| 20 to 30 | 182 | 61% | 4,670 | 18% | 24.0 | 8% |
| 30 to 40 | 104 | 68% | 3,665 | 23% | 21.5 | 11% |
| 40 to 50 | 80 | 74% | 3,650 | 28% | 22.7 | 15% |
| 50 to 60 | 71 | 79% | 3,949 | 33% | 30.1 | 19% |
| 60 to 70 | 33 | 81% | 2,163 | 36% | 17.8 | 22% |
| 70 to 80 | 31 | 83% | 2,354 | 40% | 18.4 | 25% |
| 80 to 90 | 40 | 86% | 3,418 | 44% | 26.2 | 29% |
| 90 to 100 | 25 | 88% | 2,386 | 48% | 20.6 | 32% |
| 100 to 150 | 75 | 93% | 9,325 | 61% | 89.3 | 46% |
| 150 to 200 | 36 | 95% | 6,336 | 70% | 63.5 | 56% |
| 200 to 300 | 34 | 98% | 8,305 | 81% | 91.0 | 71% |
| over 300 | 32 | 100% | 13,555 | 100% | 188.0 | 100% |
| Total | 1,428 | | 71,795 | | 639.1 | |

Source: NSW DOGR

Source: NSW DOGR

- 61% of clubs in NSW have 30 gaming machines or less, equivalent to the allowable number of machines that may be installed in any hotel in the State. Further, 88% of clubs in NSW have gaming machine installations of 100 machine or less and only 5% of clubs have more than 200 machines. 19 of the 20 sample clubs selected for analysis by the Productivity Commission have over 200 machines installed;
- 48% of all club gaming machines in NSW are installed in clubs that have 100 machines or less. Only 30% of all club machines are installed in large clubs with over 200 machines in total;

- While gaming machine net revenue is skewed towards larger clubs, it is pertinent to note that 46% of all funds invested in gaming machines in the Quarter under consideration (the most recent information available at the time of this report), were in smaller clubs with 150 machines or less.

In summary, Clubs Queensland wishes to emphasise that the Productivity Commission failed to properly assess the club market in Australia. Chapter 20 focuses on a small sample of selected large Sydney-based clubs and ignores the fact that the average club in NSW is, in fact, small with an average of 50 machines. Further, the Productivity Commission has failed to properly consider the regulatory arrangements and market composition of clubs in other jurisdictions, including Queensland.

4.4.1.3 Profile of the Queensland licensed club industry

Clubs Queensland is concerned that the Productivity Commission overlooked the size and structure of the Queensland Club Industry in making key findings and developing policy options.

The market for licensed clubs in Queensland is dominated by small venues with either no poker machines or installations of less than 20 machines. According to the Liquor Licensing Division of the Department of Tourism, Sport and Racing, and Queensland Office of Gaming Regulation:

- At 30 June 1998, there were 1,030 clubs liquor licences issued in Queensland; and
- At 31 March 1999, there were 641 licensed clubs in Queensland with gaming machines. Accordingly, 37.7% of all clubs in Queensland operate without gaming machines.

Clubs with gaming machines in Queensland are typically small organisations with minor gaming machine installations. As at March 1999, the average number of gaming machines installed in Clubs (with gaming machines) in Queensland was 28 machines, compared with the NSW average of 50 machines and the Productivity Commission analysis sample of 399 machines. The following table provides a summary analysis of published information from the Queensland Office of Gaming Regulation.

| Distribution of gaming machines and net revenue in NSW Clubs For the Quarter ended 28 February 1999 | | | | |
|--|--------------|-----------------------------------|-----------------|----------------------------------|
| Gaming machine range | Clubs | Cumulative % all clubs | Machines | Cumulative % machines |
| 10 and less | 286 | 45% | 2,024 | 11% |
| 10 to 20 | 147 | 68% | 2,250 | 24% |
| 20 to 30 | 63 | 77% | 1,610 | 33% |
| 30 to 40 | 30 | 82% | 1,097 | 39% |
| 40 to 50 | 30 | 87% | 1,401 | 47% |
| 50 to 60 | 9 | 88% | 522 | 50% |
| 60 to 70 | 9 | 90% | 590 | 54% |
| 70 to 80 | 10 | 91% | 749 | 58% |
| 80 to 90 | 13 | 93% | 1,117 | 64% |
| 90 to 100 | 8 | 94% | 769 | 69% |
| 100 to 150 | 24 | 98% | 3,059 | 86% |
| 150 to 200 | 7 | 99% | 1,197 | 93% |
| 200 to 300 | 5 | 100% | 1,293 | 100% |
| over 300 | 0 | 100% | - | 100% |
| Total | 641 | | 17,678 | |
| Av machines per club | 28 | | | |
| Source: QOGR | | | | |

As at March 1999:

- 45% of licensed clubs with gaming machines in Queensland had installations of 10 machines or less and 77% of clubs had 30 machines or less;
- There were only 5 venues in Queensland with over 200 gaming machines; and

- 47% of all machines installed in clubs in the State are in small venues with 50 machines or less and almost 70% of machines are installed in venues with 100 machines or less.

As noted, in June 1999, Clubs Queensland commissioned KPMG Consulting to undertake analysis of the Queensland Club Industry to assess the economic and social contribution to Queensland from Clubs. KPMG reviewed the audited trading statements of and surveyed 242 and 172 licensed clubs respectively to gain a clear understanding of the industry in Queensland. The key findings with respect to the industry structure, composition and size include:

- There are 206 bowls clubs in Queensland with gaming machines, accounting for 32% of gaming clubs and only 17% of gaming machines;
- The total number of sporting clubs with gaming machines in Queensland (football, bowls, surf lifesaving, golf and other sporting entities) is 512, or 80% of all clubs with gaming machines. Services Clubs comprise 14% of the clubs with gaming machines with the remaining 6% of clubs being cultural, religious and community based; and
- Services Clubs are the largest in terms of machines, collectively accounting for 27% of all machines in clubs in Queensland and averaging 53 machines per club.

The following table summarises the distribution of clubs and machines by club type.

| Profile of clubs in Queensland and distribution of machines | | | | |
|---|--------------------------------------|------------------------------|----------------------------|---------------------|
| As at June 1999 | | | | |
| Club type | Number of clubs with machines in Qld | % of all clubs with machines | Average number of machines | % of total machines |
| Bowls | 206 | 32% | 15 | 17% |
| Cultural/religious/community | 37 | 6% | 26 | 5% |
| Football | 95 | 15% | 45 | 24% |
| Golf | 99 | 15% | 11 | 6% |
| Surf | 26 | 4% | 22 | 3% |
| Other sporting | 86 | 13% | 34 | 16% |
| RSL and Services | 92 | 14% | 53 | 27% |
| Total | 641 | 100% | 28 | 100% |

Source: KPMG Consulting

- The network of licensed clubs in Queensland is spread throughout the State with 64% of all clubs located outside Brisbane and 45% located outside the south-eastern corner of the State;
- Gaming machines are also spread throughout the State. Over 56% of all gaming machines are located outside the Brisbane Statistical Division and 35% are located outside the south-eastern corner of the State; and
- The relative concentration of gaming machines for Brisbane (7.1 machines per 1,000 adult residents) is close to the State average (6.8% of adult residents).

The following table provides a summary of the regional distribution of gaming machines in Queensland.

| Region | Number of clubs with machines in regions | % of all clubs with machines | Average number of machines | % of total machines | Gaming machines per 1000 adult residents |
|----------------------|--|------------------------------|----------------------------|---------------------|--|
| Brisbane | 219 | 34% | 36 | 44% | 7.1 |
| Gold Coast | 54 | 8% | 37 | 11% | 7.9 |
| Sunshine Coast | 42 | 7% | 31 | 7% | 10.3 |
| Moreton remainder | 41 | 6% | 14 | 3% | 4.8 |
| Wide Bay Burnett | 56 | 9% | 26 | 8% | 8.7 |
| Fitzroy/Central West | 53 | 8% | 22 | 7% | 8.5 |
| Mackay | 40 | 6% | 19 | 4% | 8.6 |
| North/North West | 31 | 5% | 19 | 3% | 3.6 |
| Far North | 40 | 6% | 23 | 5% | 5.9 |
| South West | 14 | 2% | 9 | 1% | 6.6 |
| Darling Downs | 51 | 8% | 18 | 5% | 6.4 |
| Total | 641 | 100% | 28 | 100% | 6.8 |

- Based on KPMG's survey of 172 licensed clubs in Queensland, the average club has the following facilities:
 - 28 gaming machines;
 - total dining capacity for up to 176 persons;

- bar and lounge capacities for up to 176 persons;
- where functions facilities are included in clubs, the function room can seat a maximum of 200 persons; and
- a range of sporting facilities such as football grounds, change rooms, golf courses, bowls greens, surf life saving facilities and meeting rooms.

With the exception of two clubs in Queensland, one in Mt Isa which has temporary accommodation suitable for mining personnel and the other being the United Services Club in Brisbane for members only, no other club in Queensland currently owns or operates accommodation facilities. A very small number of clubs own adjoining properties for future possible club development and some of these properties may be commercial premises. No more than 4 clubs in Queensland have minor retail outlets located close to foyer areas, selling exclusively to members, items that are related to the Club operations. For example, Southport Sharks Australian Rules Club has a small shop selling club merchandise, including caps, jumpers and key-rings. Clubs Queensland wishes to emphasise to the Productivity Commission that clubs in Queensland have not extended to extraneous businesses. Rather, clubs in Queensland, while experiencing significant growth since the introduction of gaming machines, have focused on the core elements of their businesses, namely, bar, catering, members' services, gaming, sport and recreation.

- The average level of trading revenue per club (with gaming machines), based on an analysis of 1998 financial results for 242 clubs, was \$1.4 million. This accords with the Australian Bureau of Statistic's analysis of clubs for 1997/98, which assessed average revenue for clubs with gambling facilities in Queensland at \$1.5 million.
- On average, licensed clubs in Queensland with gaming machines earned \$707,000 from machine gaming, \$410,000 from bar operations, \$143,000 from catering, \$39,000 from membership subscriptions and \$118,000 from other sources, such as Keno and TAB commissions.

In summary, the Queensland club industry is typically profiled by venues that:

- Are small;
- Cater to a localised market catchment area and spread through regional Queensland;
- Are based around sport and sporting facilities;

- Have small gaming installations;
- Operate only core trading departments; and
- Have modest expansion plans.

The profile of the typical clubs is very different to the clubs examined by the Productivity Commission in Chapter 20 of the draft report. In particular, with the exception of a small number of isolated examples, clubs in Queensland have conducted business within the “core range” of undertakings. Accordingly, Clubs Queensland submits that the clubs in Queensland have not lost their “mutual character”.

4.4.2 Price discounting and cross subsidisation

The Productivity Commission asserts that:

- Clubs engage in price discounting in bar and catering operations;
- Clubs cross subsidise catering and bar operations and this suggests below-market pricing; and
- Clubs can offer better odds (rate of return to players) for gaming machines because clubs can reap the benefits associated with economies of scale arising from access to greater numbers of machines.

This section deals with each of these contentions separately.

4.4.2.1 Price discounting and cross subsidisation in bar and catering operations

The Productivity Commission made the following key assertion on page 20.23:

While the Commission has received no documentary evidence that other prices charged for club services [bar and food] are less than those charged in commercial establishments, there is anecdotal evidence that this is the case. Furthermore, club annual accounts show cross-subsidisation of meals and bar services...which suggest below market prices.

Clubs Queensland is disappointed that the Productivity Commission was prepared to accept anecdotal evidence on pricing, in the absence of documentary evidence, in making the significant finding that clubs engage in below-market pricing. Furthermore, the draft report includes, on page 20.18, "A story about beer and gambling". The item is presented as a case example and intimates that it is commonplace for clubs to set prices at 50 cents a glass below the hotel price. KPMG Consulting undertook a small, random and independent survey, on behalf of Clubs Queensland, of the prices charged by hotels and clubs (base prices) in the Brisbane metropolitan area. The detailed results are contained in appendix A and the key findings are summarised in the following table:

| | Average full-strength 10 ounce beer | Average reduced alcohol 10 ounce beer | Basic mixed spirit 7 ounce |
|------------|--|--|----------------------------|
| Clubs | \$1.82 | \$1.70 | \$3.08 |
| Hotels | \$1.90 | \$1.78 | \$3.27 |
| Difference | 4.0% | 4.5% | 5.9% |

The key points to emerge from our survey are as follows:

- Hotel full-strength "pot" prices for hotels varied from \$1.50 to \$2.10 and averaged \$1.90. Club "pot" prices for heavy beer ranged from \$1.60 to \$1.95 and averaged \$1.82 for the sample of clubs surveyed, only 4% less than the average for hotels;
- Reduced alcohol "pot" prices for the sample of Brisbane hotels surveyed ranged from \$1.50 to \$2.10 and averaged \$1.78. By comparison, club prices ranged from \$1.55 to \$1.85 and averaged \$1.70, only 4.5% less than the average for hotels; and
- The mean price for basic mixed spirit drinks in the sample of hotels was \$3.13, compared with clubs at \$3.27, a discount of only 5.9%. The prices charged by hotels ranged from \$2.15 to \$4.00, compared with \$2.55 to \$3.50.

Both hotels and clubs engage in price discounting for limited periods of time. For example, a number of clubs and hotels reported \$1.00 "pots" during designated times. Some clubs offer members' discounts while hotels promote discounted "jugs" of beer and spirits. Based on this simple survey, it appears that hotels' low price points are generally lower below those charged by clubs, however, the average price for drinks is marginally lower in clubs than in hotels. Hotels tend to promote "jug" specials while clubs focus their price discounting towards members.

A further measure of the extent of price discounting in bar trading may be gained from an analysis of the Australian Bureau of Statistics' survey of clubs, pubs, taverns and bars (catalogue 8687.0). The following table summarises the margins earned on liquor sales for hotels and clubs in Australia, both with and without gambling facilities. Premises with gambling facilities are those that offer any one of the following gaming and gambling options:

- Poker/gaming machines;
- TAB betting; or
- Keno.

| Beverage gross profit comparisons for hotels, taverns and bars, compared with clubs | | | | | | |
|--|--|----------|---|----------|---------------------|----------|
| Australia 1997-98 | | | | | | |
| | Premises with gambling facilities | | Premises without gambling facilities | | All premises | |
| | \$'000 | % | \$'000 | % | \$'000 | % |
| Hotels, Taverns and bars | | | | | | |
| Bar sales | 2,256 | 50.3 | 969 | 71.1 | 3,226 | 55.2 |
| Take-away beverage sales | 2,229 | 49.7 | 393 | 28.9 | 2,622 | 44.8 |
| Total | 4,486 | 100.0 | 1,362 | 100.0 | 5,848 | 100.0 |
| Liquor and beverage purchases | 2,675 | 59.6 | 699 | 51.3 | 3,374 | 57.7 |
| Gross profit | 1,811 | 40.4 | 663 | 48.7 | 2,474 | 42.3 |
| Clubs | \$'000 | % | \$'000 | % | \$'000 | % |
| Bar sales | 1,321 | 92.1 | 175 | 89.9 | 1,496 | 91.8 |
| Take-away beverage sales | 113 | 7.9 | 20 | 10.1 | 133 | 8.2 |
| Total | 1,434 | 100.0 | 195 | 100.0 | 1,629 | 100.0 |
| Liquor and beverage purchases | 721 | 50.3 | 100 | 51.3 | 820 | 50.4 |
| Gross profit | 713 | 49.7 | 95 | 48.7 | 808 | 49.6 |

Source: Australian Bureau of Statistics Cat 8687.0

- Hotels, taverns and bars with gambling facilities recorded an average level of gross profit (sales less net stock purchases) of 40.4%, compared with clubs with gambling facilities, which recorded an average gross profit level of 49.7%. However, it is acknowledged that

almost 50% of the sales turnover for hotels and taverns are packaged product, intended for consumption off the premises. It is generally accepted that gross margins derived from packaged sales are significantly less than margins for bar sales and this affects the overall gross margin levels for hotels and taverns. Accordingly, gross profit margins for the hotels sector for bar sales are likely to be higher and closer to the margins earned by clubs.

- There is a significant difference between the gross margin levels for hotels, taverns and bars with gambling facilities and those without gambling facilities. The margin level for hotels with gambling facilities is 8.3% less than those without gambling facilities. By comparison, clubs with and without gambling facilities recorded similar margins on beverage sales. Accordingly, the data published by the Australian Bureau of Statistics appears to suggest that there is a correlation between the presence of gambling facilities in hotels, bars and taverns and price discounting while there appears to be little correlation between the presence of gambling facilities in clubs and price discounting.

As noted previously, Clubs Queensland commissioned KPMG Consulting to undertake a major study of the Licensed Club Industry in Queensland to determine the economic and social contribution to Queensland. The following table provides a summary of the bar operations for clubs in Queensland, based on an analysis of a sample of the audited accounts of 242 venues.

| Summary of bar operations in Queensland clubs Based on 1998 financial results | | |
|--|-------|-----|
| Item | \$m | % |
| Sales revenue | 263.4 | 100 |
| Expenses | | |
| Cost of goods | 137.6 | 52 |
| Wages | 42.2 | 16 |
| Other | 10.7 | 4 |
| Total expenses | 190.5 | 72 |
| Contribution | 72.9 | 28 |

Source: KPMG Consulting, Audited financial statements of clubs

The key elements to emerge from the KPMG analysis were:

- Gross margins averaged 48% for beverage sales across the State, with regional margin levels ranging from 35% to 55%, and
- On average, after all reasonable allocation of direct costs to the bar department, clubs earned a net margin of 28% on bar sales. Regional net margin levels ranged from 40% to 23%.

Accordingly, the assertion that bar operations for licensed clubs are subsidised through gaming machine operations for Queensland clubs is incorrect and un-supported by reliable data and research.

It is difficult to measure price discounting in catering departments because products are less homogeneous than beverage products. A meal at one establishment may be vastly different in quality, size and presentation from a similarly described meal in another establishment. For this reason, we have not conducted a survey of meal prices in hotels and clubs.

However, again, Clubs Queensland wishes to express its disappointment in the Productivity Commission for generally accepting the contention of others that all clubs engage in significant price discounting cross-subsidisation of catering services. With the exception of a cursory analysis of the reported catering surpluses for a small sample of large NSW clubs only, the Commission was presented with no evidence to substantiate the notion that clubs heavily discount catering prices.

Clubs Queensland has conducted extensive analysis of member clubs in Queensland and the results of our research is included in this report for examination by the Commission. Clubs Queensland can demonstrate that catering operations for clubs, particularly in Queensland, are the subject of price discounting and cross-subsidisation to any greater extent than at hotels, taverns and bars. The Australian Bureau of Statistics' analysis of clubs, hotels, taverns and bars provides initial support for this contention. The following table reproduces information from the 1997/98 analysis of operation for clubs and hotels. It should be noted that the report does not specifically isolate "catering purchases" as is the case with beverage purchases. Rather, the report includes catering purchases in an item called "other purchases", which includes all other items purchased for re-sale. However, despite this generality, it is assumed that catering purchases comprise the significant majority of "other purchases" in the report. Accordingly, we have referred to the assessed gross profit margin for catering operations as "notional gross profit".

Catering gross profit comparisons for hotels, taverns and bars, compared with clubs Australia 1997-98

| | Premises with gambling facilities | | Premises with gambling facilities | | All premises | |
|---------------------------------|--------------------------------------|-------------|--------------------------------------|-------------|---------------|-------------|
| | \$'000 | % | \$'000 | % | \$'000 | % |
| Hotels, Taverns and bars | | | | | | |
| Catering sales | 510 | | 172 | | 682 | |
| Other purchases* | 325 | 63.8 | 121 | 70.1 | 446 | 65.4 |
| Notional gross profit | 185 | 36.2 | 52 | 29.9 | 236 | 34.6 |
| Clubs | \$'000 | % | \$'000 | % | \$'000 | % |
| Bar sales | 423 | | 60 | | 483 | |
| Other purchases* | 250 | 59.3 | 37 | 61.1 | 287 | 59.5 |
| Notional gross profit | 172 | 40.7 | 23 | 38.9 | 196 | 40.5 |

Source: Australian Bureau of Statistics Cat 8687.0

* purchases include purchases of goods for re-sale such as foodstuffs for use in preparing meals

- The notional gross levels for clubs with gambling facilities is assessed to be 40.7%, compared with the hotel sector notional gross profit level of 36.2%;
- Similarly, the notional gross profit level for clubs without gambling facilities is assessed to be 38.9%, significantly higher than the hotel sector notional gross profit level of 29.9%; and
- The notional catering gross profit levels for clubs and hotels with gambling facilities were **greater** than the levels for clubs and hotels without gambling facilities, suggesting that there is no correlation between the presence of gambling facilities and price discounting in catering amongst clubs and hotels.

As noted, Clubs Queensland engaged KPMG to undertake a detailed assessment of the Queensland Club Industry in June 1999. The results of the analysis of catering operations are summarised in the following table.

| Summary of catering operations in Queensland clubs | | |
|---|-------------|-----------|
| Based on 1998 financial results | | |
| Item | \$m | % |
| Sales revenue | 91.8 | 100 |
| Expenses | | |
| Cost of goods | 42.3 | 46 |
| Wages | 30.4 | 33 |
| Other | 8.1 | 9 |
| Total expenses | 80.8 | 88 |
| Contribution | 11.0 | 12 |

Source: KPMG Consulting, Audited financial statements of clubs

- On average, clubs in Queensland derive a small trading surplus from catering operations, averaging 12% of catering sales in the 1998 and 1997/98 accounting periods; and
- On average, the gross profit level for catering operations for Queensland clubs was assessed to be 46% (6% greater than the notional level assessed from the ABS report, presented above).

In summary, there is no evidence to support the notion that clubs, on an industry-wide basis, either in Queensland or other Australian jurisdictions, engage in below-market pricing of bar and catering operations. Further, Clubs Queensland has been able to demonstrate that licensed clubs in Queensland, on average, do not engage in price discounting or cross-subsidisation.

Clubs Queensland acknowledges that there may be isolated cases of this activity amongst its members, however, on an industry-wide basis, there is no evidence to support the assertion that clubs engage in below-market pricing and cross-subsidisation.

4.4.2.2 Odds offered on gaming machines

The Commission found a highly significant relationship between the price of gaming on machines and the number of machines in hotels and clubs. According to the Commission (20.23), clubs are able to offer more attractive odds on gaming machines because of the economies that can be reaped through access to larger numbers of machine installations. The Commission presented an analysis of gaming machine rates of return to players for NSW clubs and hotels over varying sizes of installations. The information analysed related to the 1996/97 year. NSW is the only Australian jurisdiction that produces the information required to analyse the relationship between installation size and the hold rate for gaming machines (the percentage of funds wagered that are retained by the venue).

Clubs Queensland submits that the information analysed by the Commission is not reflective of the current position for machines in NSW, nor is it reflective of the venue hold rates in Queensland. In particular, prior to a number of industry reforms being implemented by the NSW Parliament, NSW hotels were permitted only to operate "approved amusement devices" (AADs) or "5 draw poker card machines". From April 1997, the number of machines that hotels were able to operate increased from 10 machines to 30, so long as the hotel did not operate more poker machines than AADs. From June 1998, the requirement that hotels keep at least the same number of AADs as poker machines was removed, however, the overall maximum number of machines couldn't exceed 30. In October 1998, a further 2,300 poker machines licences for hotels were released.

Accordingly, the information examined by the Commission relates to a period during which time there was a transition from AADs to poker machines. The market for gaming machines in hotels and taverns in NSW is continuing to develop and evolve. We have examined the most recent information available from DOGR (February Quarter 1999 for hotels and March Quarter 1999 for hotels and taverns) to assess whether there is a relationship between machine numbers and the hold rate for machines. The following table and chart summarise our analysis.

Relationship between gaming machine hold rate and installation size NSW clubs and hotels for Quarters February 1999 and March 1999

| Hotels | | | | | | | Clubs | | | | | | |
|-------------------|------------------|----------|----------------------------|-----------------|--------------|-------------------|-------------------|--------|----------|------------------|-----------------|--------------|-------------------|
| Installation size | Number of venues | Machines | Average machines per venue | Net revenue \$m | Turnover \$m | Venue hold rate % | Installation size | Venues | Machines | Average machines | Net revenue \$m | Turnover \$m | Venue hold rate % |
| 1 | 17 | 17 | 1.0 | 0.009 | 0.079 | 11.0 | 10 and less | 299 | 2,265 | 7.6 | 4.47 | 43.46 | 10.3 |
| 2 | 50 | 100 | 2.0 | 0.26 | 2.502 | 10.5 | 10 to 20 | 386 | 5,754 | 14.9 | 21.40 | 207.59 | 10.3 |
| 3 | 55 | 165 | 3.0 | 0.51 | 4.91 | 10.3 | 20 to 30 | 182 | 4,670 | 25.7 | 24.03 | 230.35 | 10.4 |
| 4 | 128 | 512 | 4.0 | 1.89 | 18.24 | 10.3 | 30 to 40 | 104 | 3,665 | 35.2 | 21.50 | 208.82 | 10.3 |
| 5 | 114 | 570 | 5.0 | 2.23 | 21.00 | 10.6 | 40 to 50 | 80 | 3,650 | 45.6 | 22.68 | 218.05 | 10.4 |
| 6 | 137 | 822 | 6.0 | 3.33 | 32.19 | 10.4 | 50 to 60 | 71 | 3,949 | 55.6 | 30.15 | 291.56 | 10.3 |
| 7 | 73 | 511 | 7.0 | 2.28 | 21.49 | 10.6 | 60 to 70 | 33 | 2,163 | 65.5 | 17.77 | 183.28 | 9.7 |
| 8 | 119 | 952 | 8.0 | 4.65 | 43.42 | 10.7 | 70 to 80 | 31 | 2,354 | 75.9 | 18.39 | 179.54 | 10.2 |
| 9 | 79 | 711 | 9.0 | 3.42 | 32.89 | 10.4 | 80 to 90 | 40 | 3,418 | 85.5 | 26.17 | 250.48 | 10.4 |
| 10 | 156 | 1,560 | 10.0 | 9.88 | 91.73 | 10.8 | 90 to 100 | 25 | 2,386 | 95.4 | 20.59 | 199.52 | 10.3 |
| 10 to 15 | 280 | 3,753 | 13.4 | 24.19 | 228.86 | 10.6 | 100 to 150 | 75 | 9,325 | 124.3 | 89.33 | 870.03 | 10.3 |
| 15 to 20 | 212 | 3,836 | 18.1 | 30.95 | 296.71 | 10.4 | 150 to 200 | 36 | 6,336 | 176.0 | 63.54 | 622.33 | 10.2 |
| 20 to 25 | 129 | 3,021 | 23.4 | 31.57 | 304.13 | 10.4 | 200 to 300 | 34 | 8,305 | 244.3 | 91.04 | 878.83 | 10.4 |
| 25 to 30 | 250 | 7,388 | 29.6 | 105.91 | 1,060.94 | 10.0 | over 300 | 32 | 13,555 | 423.6 | 188.04 | 1,952.53 | 9.6 |
| Total | 1,208 | 9,673 | 8.0 | 52.65 | 497.30 | 10.6 | Total | 1,326 | 43,599 | 32.9 | 296.48 | 2,882.66 | 10.3 |
| R Squared | 0.29 | | | | | | R Squared | 0.32 | | | | | |
| T statistic | 2.23 | | | | | | T statistic | 2.38 | | | | | |

Source: DOGR, KPMG Consulting

Source: DOGR, KPMG Consulting

- The average venue hold rate on machine turnover for hotels in the March 1999 Quarter was 10.6%, compared with the average hold rate for clubs for the February Quarter at 10.3%.
- The R Squared measure for hotels was 0.29 and for clubs was 0.32. Expressed differently, changes in the installation size accounted for between 29% and 32% of the movement in the hold rate for hotels and clubs respectively. The Commission's analysis on 1996/97 data resulted in an R Squared measure of 0.52 for hotels and 0.82 for clubs and reflected a period of change in the hotel and club market in NSW.

Based on the most recent data available, Clubs Queensland contends that there is very direct relationship between the size of a venue's installation and the effective price of gambling offered to the player. In fact, the relationship between the player payout rate and net machine revenue (turnover less all payouts to players) is direct and close to linear until a point beyond which increasing the payouts to players actually results in reduced revenues. Increasing the player payout rate provides players with more entertainment time on machines for the same investment. The player payout rate at which the marginal revenue becomes close to zero will occur in a venue when capacity constraints prevent players from gaining access to machines. While some smaller venues may experience peak trading times when players are unable to gain access to a machine, it is submitted that no venue has substantially reached this point in its price/revenue relationship for machine gaming.

4.4.2.3 Summary on pricing and cross-subsidisation

In summary, Clubs Queensland wishes to make the following key points with respect to pricing and cross-subsidisation:

- The Association is disappointed that the Productivity Commission was prepared to accept anecdotal evidence on pricing, in the absence of documentary evidence, in making the significant finding that clubs engage in below-market pricing;
- There is clear evidence, stemming from a rigorous analysis of audited annual reports for 242 licensed clubs in Queensland for 1998 and 1997/98 that bar and catering operations are run as individual profit centres, notwithstanding an acknowledgment that isolated cases of cross-subsidisation and below market pricing may exist, both in clubs and hotels;
- Australian Bureau of Statistics analysis further supports Clubs Queensland's contention that clubs do not engage in significant below-market (below the general level that hotels charge) pricing of bar and catering services;
- A small survey of 20 clubs and 20 hotels in the Brisbane area shows that there are negligible differences between the prices for beer and basic spirits charged by hotels and clubs;
- There is very little relationship between the size of gaming machine installations and the effective price of gaming on machines, based on recent NSW information.

Accordingly, Clubs Queensland requests that the Productivity Commission amend its findings with respect to price discounting and cross subsidisation with respect to clubs. Further, Clubs Queensland urges the Commission to consider other markets, other than the NSW "super club" sector when developing key policy.

4.4.3 Efficiency concerns

4.4.3.1 Introduction

As noted, the Commission accepted the view that clubs throughout Australia engage in wide-spread and consistent setting of below market prices, cross-subsidisation of services and expanded investment into "the commercial world" (a term adopted from the submission by the AHA). The Commission concluded that these practices by clubs have efficiency implications. However, the Commission concluded that if the pre-tax rate of return on investment for clubs is comparable to investments elsewhere, then there are no impacts on efficiency. This section of the submission provides evidence of the pre-tax rate of return for the Club Industry, and compares the rate of return with listed entities and other commercial enterprises.

4.4.3.2 Comparable rates of return

It is difficult to source available data to measure and compare rates of return for different sectors of the economy. The best measure of the rate of return of a sector is the pre-tax rate of return on net assets employed. However, this measure is not easily ascertainable for sectors of the economy. Another measure, which is more easily obtained, is pre-tax earnings as a percentage of total sales (revenue).

The Australian Bureau of Statistics' 1997/98 analysis of clubs, hotels, tavern and bars (catalogue 8687.0) compares the pre-tax rate of return (earnings as a percentage of sales) for hotels, taverns and bars with clubs. The following table presents a summary of the findings of the study.

| Rate of return comparison – hotels and clubs Pre-tax earnings as a percentage of revenue 1997/98 | |
|--|------|
| Venues with gambling facilities | |
| Hotels, taverns and bars | 8.9% |
| Clubs | 9.6% |
| Venues without gambling facilities | |
| Hotels, taverns and bars | 5.7% |
| Clubs | 7.1% |

Source: ABS Catalogue 8687.0



Based on the ABS study for 1997/98, the average pre-tax levels of earnings, expressed as a percentage of sales, for clubs are higher for clubs than hotels, taverns and bars. This general finding is consistent for both venues with and without gambling facilities. It is acknowledged that the following factors may account for some of the differences:

- Clubs generally pay less state gaming machine taxes; and
- Clubs without gambling facilities often benefit from voluntary labour.

However, despite these acknowledged factors, the ABS analysis provides no evidence of inefficiencies in the operations of clubs compared with the hotels sector.

StateX, the now disbanded statistical research arm of the Australian Stock Exchange reported the annual pre-tax level of earnings (earnings before income tax) as a percentage of sales revenue, for companies listed on the Australian market. This measure includes funding expenses (mainly interest on borrowed funds) with respect to financing arrangements and is comparable with the ABS analysis presented above. The last report was published in 1995, showing results for the 1994 year. A summary of the results is presented in the following table with comparison earnings levels for clubs with gambling facilities for 1994/95 and 1997/98.

| Pre-tax earnings as a percentage of sales Australian listed companies for 1994 year | |
|--|--|
| Industry group | 1994 pretax earnings as a percentage of sales |
| Oil and Gas | 26.9% |
| Gold | 22.2% |
| Solid Fuels | 13.6% |
| Diversified Resources | 13.4% |
| Tourism and Leisure | 11.6% |
| Media | 11.5% |
| Clubs with gambling facilities 1994/95* | 10.3% |
| Clubs with gambling facilities 1997/98* | 9.6% |
| Chemicals | 8.5% |
| Other Metals | 8.2% |
| Diversified Industrials | 7.9% |
| Paper and packaging | 7.7% |
| Alcohol and Tobacco | 6.6% |
| Developers and Contractors | 6.6% |
| Engineering | 6.2% |
| Food and Household | 6.0% |
| Building Materials | 5.9% |
| Miscellaneous Services | 4.9% |
| Entrepreneurial Investors | 3.6% |
| Miscellaneous Industrials | 3.1% |
| Retail | 2.2% |
| Transport | 1.1% |
| All Company Average | 7.5% |
| All Company Median* | 4.2% |

Source: Stock Exchange Financial and Profitability Study - Statex 1995

* ABS Cat 8687.0

- The pre-tax level earnings levels for clubs, in both 1994/95 and 1997/98, expressed as a percentage of sales revenues, were greater than the "all company average" for listed Australian companies in 1994 (7.4%); and

- In addition, the performance levels of clubs with gambling facilities were generally above most industry sectors for 1994.

Accordingly, comparing the operating margins for clubs in Australia with margins for other industry sectors reveals that there is no compelling evidence of operating inefficiencies for the Club sector.

4.4.4 Equity concerns

The Productivity Commission raised concerns over the effect on equity as a result of the benefits afforded to licensed clubs through the principle of mutuality. In particular, the Commission is:

- Concerned at the level of financial benefits that the Club Industry contributed to the community and sought clarification and evidence of the level of benefits provided;
- Of the view that the tax foregone by governments as a result of the principle of mutuality may be better in the hands of government rather than clubs to applied more equitably, on public goods such as roads, hospitals and schools for example; and
- Of the view that there will be inefficiencies resulting from mutuality where clubs are expanding into areas of economic activity previously untouched by clubs (such as hairdressers and butcher shops), that may undermine the profitability of those enterprises and generate inequitable capital losses for existing owners.

Clubs Queensland provides comments on each of these concerns.

4.4.4.1 *Contribution of clubs to the community*

After an extensive review of the regulatory models in NSW ACT and other gaming machine jurisdictions in various countries, the Queensland Government decided in 1990/91 to introduce gaming machines through the "community owed" model. The model involved granting permission to operate gaming machines for both hotels and clubs, with clubs receiving tax concessions and access to more machines over hotels and taverns. After some amendments, licensed clubs are required to pay poker machine taxes in accordance with a sliding scale of rates. The taxation amounts are calculated by the Queensland Office of Gaming Regulation and transferred to the Queensland Treasury which, in turn, transfers 8.5% of the funds collected to the Community Benefit Fund. Queensland Treasury makes allocations from the total taxes to the Sports and Recreation Fund (22% of total funds in 1998) and the Charities and Rehabilitation Fund (13.4% of total funds in 1998). The concept of community owned gaming was supported and implemented on the basis that gaming machines would provide clubs with a means of gaining financial independence and surpluses to contribute to community undertakings.

Clubs in Queensland provide contributions to community bodies through the following means:

- Indirectly through gaming machine taxes and levies (including Keno taxes); and
- Discretionary donations, grants, subsidies, rents and in-kind support.

The following table summarises the actual and estimated gaming machine taxes and levies paid by clubs in Queensland over recent years:

| Estimate of Gaming Machine Taxes and Levies for Licensed Clubs and Hotels | | | | | | | |
|---|-------------|-------------|-------------|--------------|--------------|--------------|-----|
| Year ended 30 June 1993 to 1998 | | | | | | | |
| Year ended 30 June | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Club gaming machine taxes | 35.6 | 54.2 | 64.0 | 74.9 | 80.3 | 74.2 | |
| Sports and recreation fund* | 11.8 | 17.9 | 21.4 | 24.8 | 25.9 | 29.6 | |
| Community benefit fund | - | 0.7 | 7.9 | 10.9 | 13.5 | 11.6 | |
| Charities and rehabilitation levy* | - | - | - | - | - | 17.9 | |
| Total estimate for clubs | 47.4 | 72.7 | 93.2 | 110.6 | 119.7 | 133.3 | |

Note: 1998 distributions are notional only and estimated by KPMG based on total amounts

Source: QOGR, Queensland Treasury, KPMG Consulting

These allocations also include minor funds from State-wide Keno taxes.

Accordingly, over a six year period, clubs in Queensland have generated \$577 million in gaming taxes, comprising \$131 million in contributions to the Sports and Recreation Fund, \$44.6 million to the Community Benefit Fund and \$17.9 million for the Charities and Rehabilitation Fund. \$383 million were contributed to consolidated revenue.

The level of direct/discretionary community contributions made by clubs is difficult to assess. For example, in the case of Surf Life Saving Clubs, Rugby League Football Clubs and RSL Services Clubs, the social clubs operate the licensed venue and pay rents, donations and grants to the owners of the premises, typically the sporting or community body related to the social club. Expenses associated with the maintenance and improvement of playing grounds and other sporting facilities regularly are not captured in sets of accounts of a club as identifiable expense items. In addition, donations and other community contributions made by licensed clubs are often not recorded within the profit and loss statements as a separate line item. Accordingly, the real levels of discretionary donations and grants made to sporting and community bodies by licensed clubs are difficult to assess accurately.

Based on KPMG's analysis of the profit and loss statements for licensed clubs for 1998, it appears that the total level of direct discretionary donations to community groups from licensed clubs was \$10.7 million for the year or 1.2% of total gross revenues. However, the survey conducted by KPMG showed that the level of sponsorships, donations and in-kind support is considerably higher than that indicated by licensed clubs profit and loss statements.

As shown in the following table, the KPMG survey indicated that, on average, licensed clubs provide support (both cash and in-kind support) equivalent to approximately \$122,000 per club per annum. This amount equates to approximately \$79 million per annum for the Queensland Licensed Club Industry.

| Queensland Licensed Club Industry : Estimates of Annual Community Support | | | | | | | | |
|---|-----------|-----------------------------------|------------|-----------|-------------|-----------|------------|------------|
| Category | Bowls | Cultural/ Community/ Social | Football | Golf | Other sport | RSL | Surf | Total |
| Average annual support per licensed club: | | | | | | | | |
| Sponsorships | 3,750 | 7,750 | 135,250 | 3,500 | 30,000 | 14,250 | 131,500 | 33,500 |
| Donations | 3,500 | 5,750 | 25,250 | 9,500 | 8,250 | 32,250 | 191,000 | 20,000 |
| In kind | 1,300 | 7,000 | 231,000 | 17,750 | 46,750 | 61,750 | 392,750 | 68,750 |
| Total Support | 8,550 | 20,500 | 391,500 | 30,750 | 85,000 | 108,250 | 715,250 | 122,250 |
| Average annual support expended by | | | | | | | | |
| Licensed Club Industry: | | | | | | | | |
| Sponsorships | 772,500 | 286,750 | 12,848,750 | 346,500 | 2,580,000 | 1,311,000 | 3,419,000 | 21,564,500 |
| Donations | 721,000 | 212,750 | 2,398,750 | 940,500 | 709,500 | 2,967,000 | 4,966,000 | 12,915,500 |
| In kind | 267,800 | 259,000 | 21,945,000 | 1,757,250 | 4,020,500 | 5,681,000 | 10,211,500 | 44,142,050 |
| Total Support | 1,761,300 | 758,500 | 37,192,500 | 3,044,250 | 7,310,000 | 9,959,000 | 18,596,500 | 78,622,050 |
| Source: KPMG Consulting | | | | | | | | |

These levels of direct and discretionary contributions equate to 3.8% of licensed club revenue or 7.6% of gaming machine revenue for cash contributions and 4.9% of licensed club revenue or 9.7% of gaming machine revenue for non cash contributions, respectively. The total value of community contributions from clubs in 1998 was equal to 8.7% of total revenue and 17.4% of gaming net revenue.

As shown, the biggest supporters of the community are Surf Clubs, Football Clubs and RSL Clubs.

Combining the level of discretionary contributions from clubs with the level of gaming taxes contributed allocated towards the Sports and Recreation Fund, the Community Benefit Fund and the Charities and Rehabilitation Fund, the total value of contributions from clubs in 1998 is estimated to be in the vicinity of **\$138 million**.

4.4.4.2 *Alternative uses of the taxes foregone as a result of the principle of mutuality*

The Productivity Commission asserts that the principle of mutuality has resulted in a foregone taxation value to the Federal Government in the vicinity of \$100 million (assuming that clubs were fully taxable commercial entities) after adjusting for dividend imputation equivalent effects. Further, the Commission adopts the view that the tax foregone by governments as a result of the principle of mutuality may be better in the hands of government rather than clubs to be applied more equitably, on public goods such as roads, hospitals and schools for example.

Clubs Queensland submits that the Commission's estimates of the taxation foregone by the Federal Government may be overstated for the following reasons:

- Fully taxable commercial entities use a number of legal mechanisms to arrange their business undertakings in such a way to minimise income tax. It is submitted that licensed clubs have very little incentive to minimise income tax, because income tax has traditionally represented a relatively minor cost item, compared with the state and territory-based taxes facing clubs. The club industry has not developed the "culture" of tax minimisation that has been developed in other parts of the business sector. It is worth noting that, according to Statex (ASX research), in 1994 listed Australian companies paid, on average, an effective tax rate of 27.4% of pre-tax profits, compared with the prevailing company tax rate of 39% at the time.

If clubs were to be made fully taxable entities, it is submitted that the industry would engage in a range of tax minimisation strategies that are common to the fully taxable business sector. The \$100 million estimate of tax foregone by the Commission does not account for this probable outcome.

- It is the view of the Commission that the principle of mutuality has been a catalyst in the development of the Club Industry in Australia. If this view is adopted, then it follows that without the application of the principle of mutuality, the Industry would not have developed to its present size and future growth will be significantly less than it otherwise might be. Accordingly, the \$100 million estimate is an estimate that is generated significantly *as a result of* the application of the principle of mutuality to clubs.

As noted, the Commission has made the suggestion that the tax foregone by governments, as a result of the principle of mutuality, may be better used by governments than clubs and that governments apply funds in accordance with more equitable principles. Clubs Queensland has attempted to obtain information to either substantiate or refute the assertions that governments more efficiently use funds, compared with non-government sectors. Clubs Queensland commissioned KPMG to undertake the following steps in an attempt to compare the efficiency of government expenditure with that of expenditure in the non-government sector (one measure for government efficiency is the "dead weight cost" of government activity:

- Reviewed recent reports, prepared by the Productivity Commission, on government trading entities (Review of Government Trading Entities) and government services (1999 reports);
- Interviewed academic and research staff members at the University of Queensland Economics Department on the issue;
- Obtained and reviewed recent reports from ABS and the Bureau of Industry Economics; and
- Accessed research databases including Reuters, IBIS and the UQ economics and business library.

However, we were unable to source appropriate research to substantiate the Commission's assertion. Clubs Queensland would greatly appreciate the Commission providing it with the source of reference material to confirm its assertion in this regard.

The Commission further suggests that governments spend money more equitably and effectively than the clubs industry. The draft report states that clubs benefit only a narrow sector of the community, while expenditure by governments benefits the broader community. However, the Commission does not produce evidence to substantiate this assertion. In response, Clubs Queensland makes the following comments:

- Based on the recent research conducted by KPMG for Clubs Queensland, it is estimated that there were 2.4 million memberships sold by Queensland clubs in 1998. Many people hold memberships to several clubs. A survey of 1,713 residents of Queensland, undertaken by CMP Marketing on behalf of Clubs Queensland in 1998, concluded that 46% of respondents held at least one membership to a club. Applying this percentage participation rate to the Queensland adult population results in the conclusion that 1.2 million adult Queenslanders hold, on average, membership to two clubs. Accordingly, the network of clubs in Queensland affects a significant proportion of the population. The suggestion that clubs only benefit a narrow proportion of the population is therefore not supported by Clubs Queensland's research data results.
- Decisions on funding allocations to community programs from government bodies are made in accordance with strict principles. However, in some widely publicised cases, political considerations may influence the allocation of government funds. In these cases, Clubs Queensland contends the government sector allocated funds inefficiently and inequitably.
- The Commission acknowledged the view that clubs, in the majority of cases, are integral parts of local communities and the governing bodies of clubs have the detailed knowledge of local community needs to be able to channel resources into activities which the local community highly values. As noted previously, the club network in Queensland is spread across the State such that all regional and most

remote communities have access to club facilities and services. In this regard, we have re-produced the following results of the 1998 primary market research, conducted by CMP Marketing for Clubs Queensland.

| Results of key attitude questions from CMP Research 1998 | | | | | | |
|---|----------------|--------------|----------|-----------------|-------------------|----------|
| (n=1713) | Strongly agree | Partly agree | Neither | Partly disagree | Strongly disagree | Unsure |
| Survey Question/proposition | % | % | % | % | % | % |
| The Club Industry is vital for funding and provision of local sports. | 51 | 31 | 1 | 5 | 3 | 8 |
| The growth in the number of Clubs since 1993 in Queensland has been bad for local communities. | 8 | 14 | 3 | 23 | 33 | 18 |
| Generally clubs care about their local communities. | 45 | 31 | 2 | 6 | 7 | 9 |
| The Club Industry is responsible in their provision of gaming facilities to the community. | 29 | 28 | 2 | 11 | 17 | 14 |
| Clubs have a tax advantage over other hospitality providers such as hotels and restaurants. | 19 | 12 | 1 | 4 | 5 | 59 |
| Clubs provide vital employment and tourism opportunities in local communities. | 54 | 33 | 1 | 4 | 3 | 5 |
| Clubs provide a safe environment for socialising and entertainment. | 60 | 26 | 2 | 4 | 4 | 5 |
| The Club Industry is vital for funding of community bodies such as hospitals, aged care, schools and welfare organisations. | 20 | 24 | 2 | 11 | 14 | 28 |
| CMP Marketing Services, 1998 | | | | | | |

We draw the attention of the Commission to the following key points:

- 82% of respondents agreed to the proposition that the Club Industry is vital for providing funding for and the provision of local sport;
- 56% of respondents disagreed with the proposition that the growth in clubs has been bad for local economies;
- 87% of respondents agreed with the proposition that clubs provide vital employment and tourism opportunities in local economies;

- 86% of respondents agreed that clubs provide a safe environment for socialising; and
- 44% of respondents agreed that clubs are vital for funding community bodies. 25% disagreed or partly disagreed and 28% were unsure.

Finally, the Commission asserted that inequities will exist when clubs expand into new areas and undermine the profitability of existing operators as a direct result of club's benefits flowing from the principle of mutuality. The Commission made reference, by way of example, to the submission of Forresters Resorts.

This assertion will only be substantiated if it can be shown that clubs:

- Have, in fact, expanded into non-core business undertakings to a significant degree; and
- Engaged in below-market pricing of services and goods in non-core business undertakings, funded through the application of mutuality.

However, no evidence has been produced by the Commission to substantiate this assertion. In previous sections of this response paper, Clubs Queensland has demonstrated that:

- Queensland clubs have not, in fact, expanded into non-core activities; and
- Queensland clubs have not, in fact, engaged in systematic and market-wide below-market price setting for core activities.

4.4.5 Governance issues

The Productivity Commission suggested that the governance arrangements in clubs may be weaker than those in most private commercial businesses. The Commission said that managerial performance of public companies is subject to self-interested scrutiny by shareholders, and disciplined by the threat of takeover. In contrast, club members have weaker incentives to demand the best rates of return on investment since they can only benefit from improved club facilities, rather than through cash dividend.

Clubs Queensland makes the following comments in response to this suggestion:

- The boards and committees of clubs are elected by voting members, in accordance with the constitutional requirements of each club entity. While Clubs Queensland cannot provide data on the terms of directorships, typically, directors and committee members serve annual terms. Clubs Queensland is aware of no authoritative source of information that substantiates the assertion that clubs have weaker governance arrangements. From the experience of the Association, directorship and committee positions at most clubs are vigorously contested within a competitive environment;
- Clubs Queensland acknowledges that, on balance, directors and committee members of community clubs may not possess the level of commercial skills and experience of their public or private company counterparts, however, the Commission should not confuse this issue with the issue of corporate governance;
- All licensed clubs in Queensland must be have their financial accounts audited by a registered company auditor. Audited accounts are then lodged with the Australian Securities Commission or the Queensland Office of Fair Trading. The Boards and committees and their actions and performances are presented for scrutiny at annual general meetings each year. Club members often have a strong association with their local club entities and actively scrutinise the operations of the Club. Through its assertions, the Commission is assuming that financial interests are a stronger motivating factor than personal vested interests that are common in the club environment;
- In terms of probity standards, the gaming operations of clubs must be audited annually. In addition, the corporate entity (club) and the management of clubs involved in gaming machine operations are required to be licensed following extensive investigations by the Queensland Office of Gaming Regulation;

In 1997, KPMG conducted a survey of fraud and non-fraud criminal conduct within the Victorian Gaming and Liquor Retailing industries in association with the Victorian Casino and Gaming Authority, Australian Hotels Association (Victoria), Licensed Clubs Association of Victoria, TABCorp, Tattersalls and Returned and Services League of Australia. Surveys were sent to 2,442 industry participants with or without electronic gaming machines. Replies were received from 616 venues representing an overall response rate of 25%. The survey sought to obtain information on the following:

- The level of fraud experienced by each industry during 1996;
- The financial impact of each fraud for venues suffering loss;
- How the fraud was detected;

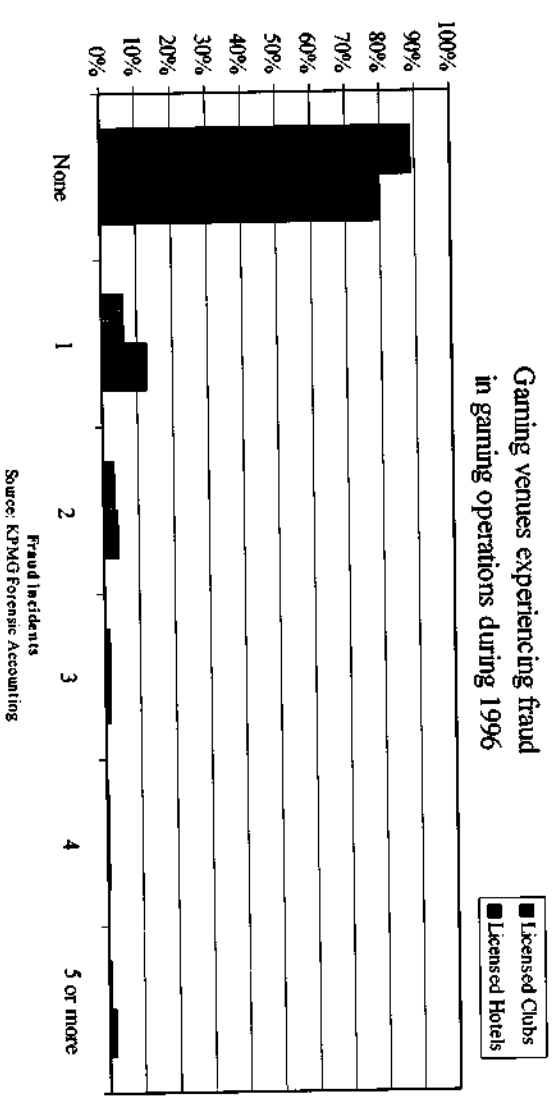
- How the organisation responded to the fraud; and
- The internal weaknesses existing at the time of the fraud that may have been a contributing factor.

While this survey only relates to the Victorian market, it is indicative of the relative incidents of corporate "misbehaviour" in licensed clubs. The following table summarises the key results of the investigation.

| Incidents of fraud in gaming and liquor retailing | | | |
|--|---|---|---|
| | Non-gaming venues (Non-gaming fraud) | Gaming venues (Gaming fraud) | Gaming venues (Non-gaming fraud) |
| Experienced fraud | | | |
| Total | 20% | 15% | 15% |
| Licensed Clubs | 13% | 11% | |
| Licensed Hotels | 25% | 20% | |
| Avg # of frauds | | | |
| Total | 0.41 | 0.36 | 0.18 |
| Avg cost per fraud | | | |
| Total | \$873 | \$838 | \$147 |
| Source: KPMG Forensic Accounting, 1997 | | | |

The investigation revealed that:

- Clubs both with and without gaming facilities experienced less incidents of fraud than hotels.
- The incidents of fraud and frequency of incidents were both lower in clubs than hotels.



In summary, Clubs Queensland submits that club boards and committees are subjected to at least as strong governance arrangements as their private and public company counterparts.

4.5 Suggested policy responses – Chapter 20

The Productivity Commission examined five policy options in respect of principle of mutuality. Clubs Queensland is of the opinion that the Commission has produced no evidence to support its key findings. Accordingly, the Association rejects all the policy options suggested by the Commission. However, despite this stance, Clubs Queensland seeks to comment on each of the policy options suggested by the Commission in its draft report.

4.5.1 Taxing poker machine surpluses by quarantining them from mutuality

The key elements of this option are:

- Bar and catering operations would remain the subject of the application of the principle of mutuality;
- This option would require legislation to remove poker machine income from the principle of mutuality;
- This option may result in increased pay rates to players. Increased payments to players would represent deductible income and provide players with a tax-free benefit; and
- The applicable tax rate would need to be calculated to account for dividend imputation effects.

Clubs Queensland is of the view that this policy option is unworkable for the following reasons:

- It penalises all clubs, no matter the size;
- There is no evidence that this strategy would address any of the perceived issues raised in Chapter 20;
- It is likely to lead to the adoption of tax minimisation strategies, which are inherently inefficient, within clubs; and
- It would be burdensome to administer and create additional compliance costs for both clubs and government and possibly lead to further inefficiencies.

4.5.2 Venues to receive gaming revenue on a commission basis

The key elements of this option are:

- All gaming income to be received as commissions from an external party, similar to the Victorian gaming model; and

- The policy option would require significant restructuring of the industry, including divesting clubs of machines and investing them in third party operators.

Clubs Queensland is of the view that this policy option is unworkable and inappropriate for the following reasons:

- The policy has the potential to result in the development of an anti-competitive market and increase the commercial power of gaming operators such as Tattersalls and TABCORP (as is the case in Victoria);
- The policy would divert gaming revenue from the community sector to the private sector; and
- The policy would contravene the recent amendments to the Gaming Machine Act 1991, which were fully supported by the Club Industry.

4.5.3 Increase state taxes on poker machine revenue

The key elements of this option are:

- The price of playing gaming machines may rise to compensate for the additional tax;
- This option simply removes the source of super profits rather than effects of mutuality; and
- May be easy to implement; and
- Tax rates in high tax states and territories may not change.

Clubs Queensland is of the view that this policy option is inappropriate for the following reasons:

- There is no evidence that increasing taxes results in increased prices for gaming and therefore reduced demand. In high tax jurisdictions such as Victoria, the price of gaming is as low as relatively low tax environments such as NSW;

- There is no evidence that funds are distributed better in the hands of government than in the community sector. In fact, some clubs in regional areas of Queensland believe that the amount of funds paid via a government levy into the Community Benefit Fund is greater than the amount returned to their region in the form of grants from this fund;
- Clubs are an effective mechanism to distribute funds to community causes as they have the best knowledge of the priority needs of the local community, with no political bias.

4.5.4 Place limits on the number of machines in clubs

The key elements of this option are:

- The ceiling limit may be as low as 40 machines (equivalent to South Australia) or 100 machines (equivalent to Victoria); and
- It is recognised that this policy would impose financial burdens on clubs that have structured their finances and commitments on greater number of machines.

Clubs Queensland is of the view that:

- The imposition of a state-wide cap on machines will produce inequities and adverse effects on smaller clubs. Scarcity of machines will result in a movement of machines away from smaller clubs to larger clubs; and
- The Queensland Government has placed caps on total machine numbers for both clubs and hotels. Clubs Queensland submits that hotels in Queensland should be capped at a maximum of 35 machines per venue and that hotel chains should be limited to operate up to a maximum of 300 gaming machines per group. This further capping of machines in hotels would help to address the continued dilution of the concept of community owned gaming in this State.

4.5.5

De-mutualise clubs

The key elements of this option are:

- De-mutualisation means converting entity from non-profit entity to fully taxable enterprises;
- Members become shareholders; and
- Entities will be able to distribute profits to shareholders.

Clubs Queensland is of the view that this policy option is inappropriate for the following reasons:

- Clubs Queensland supports the continuation of the concept of community owned gaming and the policy suggested by the Commission would dismantle the infrastructure and community mechanisms created by this approach to gaming;
- De-mutualisation of clubs would result in a purely profit-driven industry and discretionary, benevolent contributions would diminish in favour of profit maximising strategies; and
- In a competitive, profit-driven environment, self-regulated responsible gaming strategies would be more difficult to implement.

5 Summary of conclusions and recommendations

In summary, Clubs Queensland makes the following points:

- Clubs contribute significantly to the social and economic well-being of the general community;
- The club industry is concerned at problem gambling and supports self-regulated responsible gaming;
- There is no evidence to support the findings to challenge the principle of mutuality and accordingly none of the suggested policy options are relevant; and
- The Club model for community owned gaming is the most effective, efficient and equitable model for the provision of machine gaming leisure activities.