Introduction

Photo Marketing Association is part of a worldwide not for profit organisation "The Worldwide Community of Imaging Associations" designed to represent, educate and arrange annual shows for those business's in the Imaging Industry.

Membership in Australia comprises photo stores, minilabs, professional photographers, picture framers, school photographers, photo educators, department stores,consumer electronic stores, suppliers and mass merchants. Currently membership stands at over 650 Australia wide (representing around 750 shopfronts).
Our interest in this enquiry is significant. Major factors impacting our industry could be narrowed to the following:

- The impact of internet trading (both local and overseas) including pricing differences
- The channel shift from specialty stores to mass merchants and "big box" retailers
- Rental differences between large and small retailers
- Cost of doing business in Australia compared to competitors overseas
- Business viability and likely employment implications resulting from the above.

PMA surveyed all of our members seeking input for this enquiry. The resources, time and expertise available to small business prevents a large number of submissions. However the following document draws on their knowledge and experiences in their local markets. We have also drawn heavily on the submission by the Fair Imports Alliance (of which PMA is a member) as well as a submission by John Swainston who has done an outstanding job in detailing major issues from an importer's perspective.

We have attempted to summarise after each section with recommendations.

As a comment, it is difficult for trade associations to fund significant research to back what in many cases is "anecdotal" data. My belief is that already there exists clear evidence of major anomalies and opportunities in Australian Retail that may well require funded research once key areas of change are identified.

Of universal concern to our members was the ongoing dismay of Australian retailers in being discriminated against by their own government in allowing overseas suppliers and retailers to receive at minimum a 10% advantage in selling goods to Australian consumers. With the inevitable accelerating growth of overseas sourced internet trading, the loss of sales, tax receipts and employment opportunities by Australian retailers will in time affect us all.

Peter Rose
Director or Australian Activities
PMA

1. **The current structure, performance and efficiency of the retail sector and impediments to its contribution to the Australian economy; -**

Competing with Globalisation

The retail sector in Australia is currently undergoing massive change as a direct result of globalisation and its effects on domestic retail trade. Specifically, consumer acceptance of global online shopping has meant that Australian retailers are increasingly competing with overseas retailers and, as the Australian dollar strengthens and consumer confidence in shopping online grows, Australian retailers are exposed to significant pressure.

Of course, the globalisation of shopping is a logical corollary of market forces at play in the 21st century economy, and it is something which is both inevitable and unstoppable particularly with the growth of the Internet and technology in general.

However, the performance, structure and efficiency of the Australian retail sector is currently being challenged and its ability to add to the economy may be compromised as a result of globalisation and other market forces.

The Southern Cross Equities report into retail[1] identifies several reasons for the downturn in retail spending, and general retail performance, of the previous months, including:

- Unseasonal weather patterns particularly on the East Coast have driven consumers away from seasonal trends in clothing and also affected spend in food and beverage categories.
- Rising interest rates have placed strain on consumers who are restricting their spending on non-essential consumer goods.
- The strong Australian dollar has driven consumers to shop online with overseas e-tailers rather than with local retailers and domestic e-tailers. In addition, the strong Australian dollar has meant a decrease in the number of tourists visiting Australia with an increasing number of Australians choosing to travel overseas.
- The rising cost of living has seen an increase in essential household expenses, which have overtaken wages growth, and as a result, consumers are curbing their discretionary spending.

All of these factors are continuing to impact on the current performance of the retail sector in Australia with recent ABS figures showing that there was a 0.5% drop in trading across all retail categories in March 2011 as compared to March 2010[2]. This decline in spending is undoubtedly affecting all retailers, from large department stores to medium, small and micro businesses. This, in turn, is limiting the industry's ability to contribute significantly to Australia's economy.

Source: FIA

Australian consumers, it would also be fair to say were initially reluctant on-line buyers because of the fear of both the unknown in relation to deliveries from international retailers and of credit card fraud. It was interesting to note Choice Magazine's People's Choice Award for Best on-line retailer in 2011* was the off-shore eBay, followed by Apple and Amazon. Five of the top 10 were the 'big guys' off-shore. The other five were the bigger guys of Australian on-line retailing such as Ticketek, Deals Direct and the like. Choice reported that of the top 10 the majority were price oriented. It is the cheap price-orientation of many on-line sellers that is causing the hurt and the gripes among smaller bricks and mortar retailers.

[1] Southern Cross Equities, 'Retail: Where did Santa Shop?', 24th January 2011
[2] Australian Bureau of Statistics, Retail Trade, 5th May 2011
*Choice Magazine April 2011

In addition actual direct competitive selling by suppliers is also on the cards. Sony already sells direct from its website – but how successfully who is to know. If price was your first criterion you would be more likely to come to a bricks and mortar store. There have been rumours of Canon and other suppliers setting up similar services – which could potentially affect the market particularly for accessory items, provided they were competitive on price.

Local example:
In the Fremantle WA CBD ten years ago there were 12 retailers all of which had an involvement in photographic retail products and or services, now there are just 4.
Source: Valentines Camera House – Fremantle, WA

<u>Cost of doing Business in Australia</u>

Below is a list of the differing imposts carried by Australian businesses, wholesale and retail, not necessarily born by overseas entities against whom Australian business must compete. A local commercial entity must address the following costs of doing business, not incurred by their GST-free overseas competitor.

Cost of Doing Business for a <$1000 Transaction	Local Business	GST-Free O'seas-based Business
ASIC Annual Return Costs	Yes	Free
Quarterly BAS Statements	Yes	Free
State Employment Tax (5.3%-6%)	Yes	No
Monthly GST return & payment	Yes	No
Super'n Guarantee Levy (9%)	Yes	No
Import Duties (0-10%, varies)	Yes	Not if < A$1,000
GST at 10% on goods & services	Yes	Not if < A$1,000
Warranty (Competition & Consumer Law, 2010)	Yes	No
Product Stewardship Bill (2011) compliance (Product dependent)	Yes	Unknown
Freight to Consumer	Included free to all States by most wholesale businesses, or demanded by major retailers	Customer pays
Local Rent	Yes, ~ $900-$1600/Sq.M, p.a. for smaller retailers, & $400-$800 for major retailers	Often home-based, nil occupancy

The higher costs of employment, location, support, local marketing and other business costs, all add to the lack of ability to match their lower cost overseas competitor, or a non-conforming Australia-based intermediary business operating on the internet without regulation. In addition, the scale of many overseas-based businesses, especially those in the US, mean that their business models, through sheer volume, enable their employment costs, as a percentage of revenues, to be anything up to half of equivalent companies in Australia.

There are multiple cost premiums that an Australian employer must add to employment cost:

- Super – 9%
- State Payroll tax – 5-6%
- OH&S obligations, as well as Equal Opportunity implementation – Unmeasured – perhaps 0.5%.

There are also other key on-costs not necessarily born by overseas traders:

- Warranty Obligations – Up to 2.5% - implication by many that local importers will fulfil “their obligations under worldwide warranty” terms.
- Product stewardship – 0.5 – 0.75% estimated - a necessary and desirable obligation to ensure
- Environmentally responsible disposal of resources and waste goods, sometimes toxic.
- Rent premiums vs. The USA (30-50%) – just another difference in the cost of doing business
- Import Duties – generally lower than USA in high-tech, but higher than Asia which is Duty-Free on many consumer goods

In addition there are other cost differences faced by Australian importers:

The largest global markets have long been offered lower FOB prices, because of the size of the orders placed by traders from large markets (USA) or countries who pay in advance and have low costs of distribution. In the case of photo products, it is likely that Australian independent distributors will typically have paid between 5 and 15% more for goods ex-factory than their US counterparts. **This single factor is likely to be the primary base cost disadvantage faced by Australian wholesalers and retailers, and in turn by Consumers.** The further impost of GST and other on-costs described above, exacerbate this fundamental cost base difference.

Source: John Swainston

Summary

- Australian retailers, distributors and manufacturers face much higher costs and governmental regulatory pressures than overseas online retailers. There is a price to pay for that, that should apply to all.

- Manufacturers who control the supply and retail chains will prosper, the rest will be under pressure.

- Retailers in our industry are experiencing difficult trading conditions. The average percentage fall on 2010 year is 3%.

- Present government tax policy on GST free imports adds pressure to an already stressed retail sector. If nothing is done, “bricks & mortar” stores will continue to fail with a significant “knock on” effect for tax receipts and local employment.

2. **The drivers of structural change in the retail industry, including globalization, increasing household and business access to the digital economy, cost structures of the domestic retail industry, employment structure, the exchange rate and structural change driven by the resources boom;**

Structural change in retail

A recent study put together by Forrester Research and commissioned by PayPal has found that the Australian online sector alone was worth over $24 billion in 2009 with growth predicted to reach over $36.5 billion by 2013[3]. These figures demonstrate that retail is clearly moving into the online space, and traditional bricks and mortar businesses that do not already have an online presence will be impacted by the surge in online shopping.

Clearly, globalisation and Internet growth are major drivers of structural change in the retail industry and, as stipulated in the previous section, existing retailers in Australia must find ways to utilise this increased connectivity to the digital economy in addition to their existing service offerings. Indeed, the FIA strongly supports multi-channel selling strategies and believes that Australian retailers should embrace the opportunities that are made possible by the Internet.

Aside from globalisation being the principal driver of structural change in the retail sector, there are several other factors which are impacting on the way the retail industry functions currently. These include:

- *Rising retail tenancies at the whim of the shopping centre owner*
  (This issue is covered in detail on Page 7)

- *The strong Australian dollar*
  The Australian dollar has been rising steadily and is now exceeding parity with the U.S. dollar. This acts as a push factor to potential online consumers of domestic goods wanting to look to the U.S. market to source the same product. However, it is noted that over many years other comparable economies' currencies have retained a ratio of difference that has not caused this push factor (for example, the British pound).

- *The mineral boom*
  The mineral boom and its associated high disposable income and low cost of living in labour centres in the resource states, has also impacted on the rise of online shopping, simply to the extent that these remote communities are unlikely to ever be serviced by certain sections of retail (such as electrical goods and consumables). While the retail sector as a whole certainly does benefit from these increasingly affluent cohorts within the market, it could be argued that although being driven to online domestic consumption by necessity, residents in these remote yet relatively affluent communities will likely expand their online shopping as their confidence grows to include offshore purchases; thus negatively impacting on Australian retailers.

  Source: FIA

Growth of Internet Trading

Choice magazine April 2011 edition reports on eBay's "cheeky" campaign "browse it at Westfield, buy it brand new on eBay" and quotes survey respondents boasting about trying things on in department stores then buying the same items "for much less" on line. The same article says: '...the subtext is that it is somehow unpatriotic to take one's custom to other countries and undermine the business model of the chains and franchises located in big shopping centres...'. Here Choice damns all of us small retailers who have to belong to a group to survive in competition with not only big chains, but also non-tax paying external entities. Yet in the same article Choice reveals that its members expect a bricks and mortar retailer to have a wide range of products and stock at a low price.

[3] 'The Business of Australian Online Retail', Forrester Research and PayPal, 2010

It was interesting to note in the Choice magazine April 2011 edition 'Top of the Shops" people's choice for best retailers that of 12477 Choice members surveyed 71% said they shopped on-line. Within the photographic industry early on there were many stories about on-line purchases that have never arrived, waterproof housings that leaked and cameras purchased that didn't work. Equally, we now hear more and more of successful internet purchases, where the off-shore on-line retailer not only wins markedly on price, but they also offer a door to door extended warranty service – to combat that the common local retailers' defence is: "Canon Australia / CR Kennedy/ Nikon Australia won't recognise a warranty on a camera bought overseas" .

It is this area that most small retailers (I include the Camera House style of retailer in this) find the most difficult to deal with. We can't compete on price with large offshore retailers who basically operate as a warehouse. More particularly we can't compete on price when the suppliers continue with disparate international pricing policies. It is tough that the retailers ended up as the 'bad guys and rip off merchants' in the eyes of the public after the public statements by Gerry Harvey and Solomon Lew, when in fact most of us are working on really low margins and the manufacturer has been reaping the profits.

Source: Valentines Camera House – Fremantle, WA

Trading Hours

In the Productivity Commission's own paper *Economic Structure and Performance of the Australian Retail Industry* (March 2011), the added cost burdens imposed on retailers by wide diversity of trading hours (Pages 27-28), further reduce the hours over which a retailer may amortise their fixed costs of doing business. This restriction, especially in Western Australia, which already has higher transport costs, adds to price premiums for Australian consumers. Such restrictions do not exist in Asia or other tax-free overseas markets, and seldom are seen today in the USA, except in some State food-sale laws.

Source: John Swainston

Trading hours are a mess in WA and are currently in the State Government's spotlight to redefine. Combine the hotch potch of hours with two different wages regimes – Federal awards for corporate entities and State awards for many family owned and run small businesses – and the result is a minefield for the unwary.
We are a corporate entity operating in a Tourism precinct in Fremantle and can open seven days a week from 8 am to 9 pm week days, 8 am to 5 pm Saturday and 11 am to 5 pm Sunday. As a result of a special arrangement for the Fremantle City Council we can also open on any public holiday except Good Friday, Christmas Day and Anzac Day. There are five tourism precincts in the Perth metropolitan area, which all have the extra trading hours advantage over other areas, as well as over some of the large major shopping centres – eg including the largest in WA: Garden City.

The expectation of the public for weekend and holiday trading does not take into consideration the extra wages burden this brings on retailers. The hospitality industry is able to charge higher rates for peak days and holiday weekends – even local restaurants can have a general surcharge for holiday openings, but a retail store has to wear pay rates of double time for a Sunday and double time and a half for a public holiday and still sell at lowest possible prices. We have to factor a 'marketing cost' into our wages for opening on Sunday because the extra $300 approx. we pay in wages for the day, compared with the equivalent staff/hours on a week day, scarcely make it worth our while being open – in fact in bad weather in winter we often run a Sunday at a loss. We open on only one public holiday – Boxing Day – because the double time and a half wage rate makes it totally uneconomic. If it is now 'normal' for a retail store to be open on a Saturday and a Sunday – and in tourism precincts on public holidays, then adjustments should be considered to make wage rates ' normal' on these days.

It is also interesting to note that Australian on-line retailers, while they can take orders 24 hours a days, seven days a week, generally operate in normal business hours in relation to dispatch of the goods.
Source: Valentines Camera House, Fremantle, WA

Landlords and rental issues

1. Small retailers (especially those who have a point of difference for the shopping centres) are often able to negotiate a reasonable entry-level rental on a 5 year lease. The sting arrives in the negotiations on renewing the lease, especially if one is trading above average. The landlords are able to determine this because they require retailers to submit monthly sales figures to them. They know that they are able to extract a much higher rent on renewal because the retailer will not want to relocate due to a) the cost of defitting the current premises (around $10,000),
   b) fitting out new premises and c) building the business up again.

   Our view is that shopping centres should have to provide data supporting their asking rents on renewal if these rents are higher than 10% of the previous years rents within 6 months of the lease expiry date.

2. Some shopping centres require retailers to use their nominated contractors to attend to certain aspects of the shopfit – the relocation of fire sprinklers, air-conditioning ducting, and hoarding erection without the benefit of being able to negotiate the cost.

   Our view is that the centres should provide a minimum of 3 contractors for each of the above from which retailers could choose and negotiate with.

3. Shopping centres should provide their tenants with monthly sales increase or decrease percentages by segment by the 20th of each month, thus enabling tenants to compare their own sales performance with those of others in the centre.

4. It should be mandatory for shopping centre leases to be lodged for registration within 2 months of signature by the tenant. Once the lease is registered, the details become public but landlords are in the habit of lodging these for registration up to 18 months later to prevent current occupancy rates from becoming public knowledge while these rates are still current.

5. Tenants are required by landlords to submit an audited certificate of sales at the end of each financial year. As many small retailers operate as proprietary limited companies or personally and are not required by the taxation office to be audited, this creates an additional cost of up to $ 1,000 to the retailer

Some recent experiences with lease renewals:

a) Lease expires end March 2011. We have been in this location for 10 years and in the Centre for 18 years. As is usual, 6 months prior we receive a proposal for a new 5 year lease. After some negotiations, we reach an agreement mid-November with the leasing executive which he will submit to the board for approval. Mid-December he advises us that there are a few leases falling due in the area and that the whole lower level precinct is under review. We will be offered a short-term lease with the proposal to follow soon. Towards the end of February we are advised that they wish to re-locate us. The only shop available is right at the end of the lower level precinct. The entrance there is closed due to extensions taking place to accommodate a David Jones store. This is not acceptable to us. Mid-March we are advised that they will agree to a 2 year lease with the proposal to follow soon. It is now May and we have not yet seen the proposal. In the meantime, we have been on the look-out for alternative premises but have not found anything suitable in this area.
b) Lease expired in May 2010. In December 2009, the Regional Manager calls. He wishes to pay us a visit to discuss and explain their proposal for a new lease due to there being a significant increase which turns out to be 91.2%. Admittedly, the area has shown tremendous growth over 5 years and an increase was expected. In addition, there is some redevelopment work that will be commencing early in 2011 which will affect the traffic flow around us. We have managed to rreduce the asking rent but not to what we'd like.

A PMA Member in Westfield and similar locations (details on request)

Summary

- Exchange rates – major long term variance to historic US$0.75c 10 year average exchange rates in the past 12 months. This has exacerbated an underlying imbalance in competitiveness.
- Globalisation and online shopping are the principal drivers of structural change in the retail sector in Australia. It is estimated that online shopping will grow to over $36.5 billion by 2013.
- Australian retailers face increasing costs/impacts across many facets of their business
- Australian retailers face complex regulation that overseas retailers do not
- Rents need to reduce considerably to stem the decline in small/medium tenancies
- Mall vacancy rates will increase

3. **The broader issues which are contributing to an increase in online purchasing by Australian consumers and the role of online purchasing in providing consumers with greater choice, access and convenience;**

Major savings online

The following are a couple of examples of recent price checks by our members. These clearly illustrate the challenges facing retailers when competing with overseas online purchases.

Reality of the price differential for Camera Products – some real and recent examples:

- Nikon 14-24 is $1800 in Hong Kong and $2300 in Sydney
- A grey importer on Ebay in Australia is offering a 2 year Australian warranty on products and is selling a New D7000 for $1200 (freight an additional $75), best local price in Sydney is $1599.

Ongoing GST issues

Joe de Bruyn – National Secretary of the Shop, Distributive and Allied Employee's Association (the largest union in Australia) which represents 230,000 retail workers has told the Commission the present GST arrangements force "bricks and mortar" retailers to compete on an uneven playing field.
Source: SMH Monday May 9 2011.

Several high profile retailers have highlighted a perceived inequity in competition behaviour, in that goods imported under the $1000 threshold are free from duty and GST, whereas Australian retailers have to charge their customers such fees. The bulk of the adverse public commentary in both electronic and print media, to date, has come from people who aren't paying retail taxes on such personal imports. The GST is the only long-term growth consumer tax currently in Australia. Those who choose to buy offshore do so in addition because of greater range, choice, lower prices (whether because of the absence of GST or other factors,) or availability where such goods are not offered in Australia. If an item is not available in Australia, government should not artificially restrict access to such goods, provided the consumer fully bears the cost of the decision to purchase that item across the full transactional process of the supply chain, including processes that involve government agencies carrying out the laws of the Parliament.

That is what a public service is for – to serve the citizens, not to choose on grounds of administrative convenience which citizens pay tax and which don't. Once a law has passed establishing a principle that a consumption tax is payable on goods imported into Australia, it is potentially unconstitutional for the Executive branch of government to establish an arbitrary threshold giving advantages to those with sufficient funds to pay for goods to values up to $1,000. Further, it extends that privilege as many times as that consumer chooses to buy goods from other countries. It allows these persons to unfairly benefit from not sharing in the obligation of paying consumption tax that benefits all other members of society, through its 100% distribution to State governments for the funding of education, health, Police, infrastructure and the other duties of States. In the increasing prevalence of Public-Private equity ventures for infrastructure development within Australia, the principle of User Pays has been developed as a broad component of Australian life. It therefore seems inconsistent that those people who choose to purchase goods from overseas should not have to themselves directly reimburse government the full cost of processing those imports while Customs and Excise and Treasury carry out their Excise and tax collecting obligations under law.

It would be my contention that if Treasury estimates there is a significant cost to administratively process such sub-$1,000 transactions, then that estimated cost should be imposed on those who choose to import such goods directly, even if such cost imposes some inconvenience to the importer and the need to employ extra personnel within government. Any other course of action is discriminatory and inequitable, both socially, on consumers who do not or cannot avail themselves of such opportunities, and on Australian business who must comply with government laws and regulations. Source: John Swainston

Summary

- Australian corporates are discriminated against by administrative practice in favour of overseas entities.

- Online will continue to take business from retail; due to more favourable pricing from overseas due mainly to volume discounts and no GST.
- Staff reductions will follow the decline in retail bricks and mortar stores.
- Retail restructure will inevitably ensue.

4. The sustainability and appropriateness of the current indirect tax arrangements in this environment, including the impact on Commonwealth and State and Territory budgets, and the extent to which technology could reduce the administrative costs of collecting indirect taxes and duty on imported goods;

Equity in collection of GST?

It is the contention of many retailers, and smaller importers of goods that have a product value of under $1,000, that there is a major unintended consequence on thousands of retail and hundreds of Australian importing companies resulting from the administrative decisions made in relation to a tax-free allowance of $1,000 on imports.

When the "Duty Free Allowance" for personal travellers was lifted from $400 to $900 an unintended consequence of this was that only those citizens with enough disposable income to travel overseas could buy products at such concessionary rates. This change was introduced well before commercial Internet purchases had become mainstream. That law specifically prohibited the supply of such concessionary goods to be passed to third parties after importation.

For goods arriving in Australia from overseas a concession based on administrative convenience set at $1000 theoretically allows a commercial business to import goods of $365,000 in 365 individual parcels free of duty and tax. There is considerable anecdotal evidence that practices, perhaps not as significant as this, are now a major part of the black economy in which traders using eBay and other similar sales portals are not registered for GST and trade, frequently under multiple different identities.

Goods are regularly advertised on eBay with commercial addresses in Australia in which it clearly states that supply will be from Hong Kong or China. Such advertisements also regularly use as illustrations the Intellectual Property of local Brand owners by way of photographic data files copied without authorisation from the IP owner's or licensed user's website. This is a breach of copyright. Some suggest or infer that the local registered importer of such goods will undertake the warranty of such goods. The vendor implies this, since the original manufacturer covers many of these goods under the Worldwide Warranty arrangements of such branded goods.

This practice dates back to times when exclusive distribution agreements around the world provided some basis for such programs. Under the *Australian Competition and Consumer Law, 2010* such practices illegally pass the obligation of support, by implied warranty, to a third party who was not the agent for the sale of that good. Equally the prices charged for such goods give a strong impression that even for goods with a normal commercial value of above $1,000, no GST has been paid, even though an invoice may include a charge for GST.
Such practices allow retail trade to be carried on by a part of the economy of Australia in which a whole range of normal obligations of tax payment, compliance with the *Australian Competition and Consumer Law, 2010*, State and Federal employment laws etc. appear not to be enforced.

On the following page is a list of the differing imposts carried by Australian businesses, wholesale and retail, not necessarily born by overseas entities against whom Australian business must compete.

The efficiency of a given retailer's business model is not the primary driver of price inequity. The market will decide any observed deficiencies in business models over time. If books are too expensive compared to overseas, the market will gradually sort that out by forcing change in the business model of importers and retailing.

"The GST issue" is ultimately one of equity, along with costs of doing business and the desirability of government creating a level playing field. It is unjust and bad law in a competitive economy to tax one supplier and not another. It is unfair to discriminate on Australians with a capacity to pay for goods purchased from offshore and ask other less-wealthy Australians to bear the cost of that lost tax applied in other areas, or reduced services. GST not charged on sub-$1000 imports means fewer hospital beds, a diminished national educational curriculum or fewer dollars for needed infrastructure. Government should not arbitrarily permit overseas traders to trade in goods or services "connected with Australia" to have a tax advantage of 10% over Australian companies trading within Australia.

For the government to continue to ignore the Internet's dynamic change within retail segmentation, where some 20% of consumption may ultimately occur in the Online space and potentially much of it to be free from GST, is to completely distort the playing field. Under that argument an Australian retailer with a New Zealand business unit should encourage online purchases to be transacted with their NZ entity, and charter planes for daily delivery to Australia. Exports from NZ would be non-taxable or subject to tax drawback for the supplying entity under the *Closer Economic Relations* code operated between Australia and New Zealand. Clearly such a course would impose massive extra administrative workload on Customs.

The simple issue should be that consumption of goods and services associated with Australian consumption should have the same rules applied, regardless of whether supply is from an Australian entity or a foreign one. If the mantra of Government (and Opposition) is to be consistent it is clearly inequitable for overseas suppliers to be allowed to supply goods valued under $1000 free from duty and GST, while Australian retailers and importers must pay Payroll Tax, Worker's Compensation premiums, Super entitlements, State Taxes, Company Tax, FBT and Capital Gains Tax on their business, as well as imposing GST on all transactions and having to cope with higher input costs caused by nation-scale. Australians may not like to admit it, but it simply costs more to do business in this country. Australia is the size of the USA. Australia has just 22 million inhabitants, compared to 310 million in the USA. Marginal transaction costs are simply higher. Yes, if overseas manufacturers provided their subsidiaries and agents identical prices to those offered to the US, Australian retailers would have one less obstacle to globally competitive prices. But in many cases, differences in electrical standards, State and Federal safety laws, radiation compliance tests, environmental standards and other factors, contribute significantly to short-run production cost differences. There really is a difference in manufacturing 10,000 power chargers for an Australian customer, versus 130,000 for the USA.

<u>A Practical Example:</u>
Below I submit a theoretical business model that shows the consequence of a 9% loss of business, from reduced Internet activity caused by GST-free imports. With margins as fine as those found in the consumer electronics/camera industry, <5% sensitivity in volume exists before profit turns to losses.

Importantly, that loss occurs after two other key actions a company would take to arrest falling margins and revenues. Typically a 20% cut in sales personnel or sales costs would have to be made, to cut back on losses incurred. That might be jobs, it might be fewer exhibition space costs, or cancelled retail cooperative advertising. Conventionally a reduction in advertising and promotional marketing costs would also result. Finally as a loss results, no company income tax is paid. In a small company the labour numbers might at least take it below the threshold for paying State employment taxes.

Ultimately this enterprise would run out of working capital. At that point, as perhaps the only provider of local servicing backup with local parts stocks and of course employment for service technicians, local consumers would lose all local service arrangements supporting warranties under the *Australian Competition & Consumer Law (2010)*. Directors would be in breach of their obligations through no fault of their own. The lack of a level-playing-field directly would result, over time, in reduced local support, prices being raised by overseas suppliers for lack of local competition, fewer marketing dollars invested and reduced local employment.

In the Productivity Commission’s own paper *Economic Structure and Performance of the Australian Retail Industry* (March 2011), the added cost burdens imposed on retailers by wide diversity of trading hours (Pages 27-28), further reduce the hours over which a retailer may amortise their fixed costs of doing business. This restriction, especially in Western Australia, which already has higher transport costs, adds to price premiums for Australian consumers. Such restrictions do not exist in Asia or other tax-free overseas markets, and seldom are seen today in the USA, except in some State food-sale laws.

COSTS OF DOING BUSINESS: HOW MARKET MECHANISMS MIGHT PLAY OUT

When net margins are as low as is the case in camera wholesaling, a 9% reduction in volume can turn a business from a small profit to a significant loss. See theoretical model below:

	Camera Wholesaler **Pro-Forma Before GST-free imports**	**Price response to attempt to compete against tax-free imports bearing no 10% GST imports***
Sales	110	106.26

including GST		
Net Company Sales	100	96.6
Cost of Goods Sold	85	89.25
Gross Margin	15	7.35
%	1.5%	7.6%
Operating Expenses		
Selling	4.5	3.6
Marketing	5	3.5
Administrative	4	4
Total	13.5	11.1
Operating Income	1.5	-3.75
%	1.5%	-3.9%
Income Tax at 32% effective rate	0.48	-1.2
%	1.00%	-2.6%

* Real World actions resulting from competing against 9% loss of business due to GST-free impo rts
1. Lower revenue s mean prices get cut 8% to compete, increasing volume back by 5%
2. Goods don't cost the supplier any less, except lowering price increased volume, so total cost of goods actually rise s
3. With less Total GM dollars (actually half), local business cuts sales force by 20%, and drops marketing investment by 30%.
4. Admin costs of accounting, collections, service staff and management not cut, because all functions critical to the business.
5. Net income before tax has dropped from 1.5 (1.5%) to a loss of -3.9% before tax.
6. Sales personnel and local marketing has been cut, 3.75% less GST raised on local sales, no income tax to govern ment.

Source: John Swainston

<u>Employment implications</u>

Because of the advantage given to offshore online sellers through the low value importation threshold, Australian businesses are being squeezed at every corner to compete with foreign retailers. As more Australian consumers shop with offshore online e-tailers, a greater strain is placed on Australian businesses. With less consumers shopping in Australian stores, there is a decreased need for employees, causing a long-term problem which ultimately results in employment pressures for both the retail sector and the Australian Government. Employment is already a significant issue in Australia and the increase in offshore, online shopping is only compounding this issue.

Currently, the retail sector in Australia employs over 1.2 million people. Indeed, retail employment plays an important role in Australia, and according to Martin Feil, a prominent tax and industry policy consultant, 'services sector employment is supposed to be [Australia's] economic salvation now that manufacturing is meaningless'[4]. However, given that many Australian retailers are losing business to offshore online e-tailers, will retail employment still continue to be as strong as it once was? This is an issue which FIA members foresee as growing given the recent drive to offshore online shopping.

The FIA believes that the Government needs to take a comprehensive analysis of retail employment given the globalisation of the retail sector and the associated issues of the low value importation threshold. While the FIA strongly supports online shopping and recognises the need to transition the Australia retail industry into an online economy, they also recognise the importance of retaining employment in the retail sector.

Source: FIA

[4] Cite article in paper

Summary

- The Australian Government is losing a substantial amount of revenue due to tax-free imports.
- An uneven playing field exists because of the low value importation threshold and it is one which penalises domestic retailers and e-tailers.
- Removal of the low value importation threshold will enable a tax neutral, level playing field.

5. Any other regulatory or policy issues which impact on structural change in the sector.

The shift to online retail has certainly seen some consumer choice factors at play such as convenience, price, access, and an ability to research products. In addition, an increasingly confident consumer has emerged, one who is fully immersed and well versed in the digital economy. However, along with the benefits of domestic and international online shopping options, there are certain risks for consumers. Chief amongst these concerns is compliance with Australian Standards and matters related to consumer rights and warranties which may be voided in some instances. Indeed, the following situations may occur:

a) Warranty may be voided for certain products. There may be ambiguity surrounding warranty policies when purchasing items from offshore online sellers and there is also no guarantee that stated warranty policies will even be upheld, depending on where the item was purchased. Indeed, many of FIA's members reported that consumers who had purchased goods from offshore sellers were bringing them back to retail stores in order to place warranty claims. This became problematic as certain products only had international warranties which were not recognised in Australia.
b) The quality of the goods is not assured and if a consumer purchases a product not made to the highest standards, this could result in personal health and safety risks.
c) There is an increase in the probability of purchasing goods which are counterfeit. This is often the case where prices are too good to be true and the avenues for consumer redress are poor.

Ultimately, it could be argued that by shopping online, consumers themselves accept these risks; however, evidence suggests that this is becoming a real and growing issue for Australian retailers. As stipulated above, many Australian consumers are bringing products purchased offshore and online to Australian retail stores expecting warranty and statutory rights to be honoured. Most of the time, this is simply not feasible and Australian retailers are having to turn away these consumers which is having the effect of creating a negative experience for the consumer with the Australian retailer. This, in turn, acts as further incentive for consumers to transact online, just as for others it may be the 'shock' to drive them back to Australian stores. The trend, however, is that reputational credibility is being lost to the offshore online market.

Source: FIA

Summary

- **Consumers face certain risks when purchasing from offshore online sellers. There may be warranty issues, products which do not comply with Australian Standards and counterfeit items which may cause personal harm to the consumer.**
- **Warranty obligations imposed on Australian businesses under the Competition & Consumer Act (2010) – the new law is not imposed equally as a result of the GST-free import threshold, and "normal importers" bear an undue burden of compliance and negative PR from this inequity.**

Recommendations

- That Government enquire as to the impact major landlords have on competitiveness, inequities and 'tied arrangements" in dealing with tenants in a retail environment.

- That the Commission consider the basic inequity in Government agencies taxing Australian businesses for all goods and services transacting business "connected with Australia" but that it chooses, for reasons of administrative efficiency, not to tax similar goods and services supplied by entities outside of Australia, to Australian residents, and as a result of such consideration, to establish a system of fairness and equity to enable the GST element of price disparity to be removed from Retail competitiveness within Australia. Source:John Swainston

- That the Government ensures all products offered to Australian consumers, whether from home or abroad meet local electrical compliance, comply with the Australian consumer law and have Australian Sales Tax included so that one set of Australian consumers is not advantaged over another.Source:PICA

- *Branding of domestic e-tailers as 'Australian'* - The FIA strongly supports e-tailing and believes the Government has a role to play in supporting domestic e-tailers, particularly as consumers may not necessarily recognise the potential consequences of their purchases (for example, purchasing a product from an offshore online seller is a loss to the Australian economy). Government may wish to examine an online version of the 'Australian Made' logo to readily show consumers whether their product is a value add to the economy or an export of wealth. While this may not discourage Australian consumers from shopping offshore and online, it may encourage them to think before they purchase and allow them to make an informed decision. Source: FIA

- That the Commission duly note the sensitivity to marginal profitability of smaller Australian specialist suppliers of imported goods requiring service provision under Consumer & Competition Law, and that should such firms may be marginalised or fail without a more level GST tax treatment,. Australian consumers might no longer have access to local repair facilities to effect warranty cover as required by law for "reasonable" periods after local purchase. Source: John Swainston

- *Transition funding for domestic retailers to better engage in the digital economy*- Many Australian retailers (particularly small and medium businesses) may find the transition to an online economy rather daunting. Given that retailing affects a range of people within the Australian community, Government may wish to invest further funding or provide education to give retail trade the best possible environment to prosper. This is particularly critical in a globalised world where online economies are becoming the norm rather than the exception. Source: FIA

- That a User-Pays principle be established on all personal and commercial imports, such that they incur charges from the transacting instrumentalities (Customs,. Australia Post, Private Courier Companies etc…), based on the actual cost of processing such imports and born by the consumer making that import. Source: John Swainston