



**Australian Government**  
**Productivity Commission**

# Relative Costs of Doing Business in Australia: Retail Trade

Productivity Commission  
Research Report

September 2014

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### The Productivity Commission

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

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

Further information on the Productivity Commission can be obtained from the Commission's website ([www.pc.gov.au](http://www.pc.gov.au)).

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# Foreword

The retail sector makes an important contribution to the economy and employment in Australia. From a consumer perspective, retail services provide a key link that enables them to access a wide range of products from suppliers.

Whether based in Australia or elsewhere, the retail landscape is changing, which is intensifying competitive pressure on many retailers and compelling them to focus on how they do business. The ongoing development of e-commerce in particular is driving changes in consumer behaviour and expectations, while at the same time creating opportunities for businesses to alter their cost structures and reach more and different market segments.

The Commission was tasked by the Australian Government to undertake a case study of the costs faced by retail businesses in Australia, and, where relevant, to compare those to the costs faced by their international competitors. This study has found that retailers in Australia continue to operate under several regulatory regimes — such as those relating to trading hours, and planning and zoning — that unnecessarily inflate their costs and restrict their ability to innovate. However, this study also highlights that many of the cost pressures facing retailers are market driven and, therefore, require commercial responses.

The Commission is grateful for the engagement of stakeholders in the government, non-government and business sectors who participated in this study, especially those who met with the Commission and provided written submissions.

This study was undertaken by a team including Catie Bradbear, Paul Davidson, Melissa Edwards, Leonie Holloway, Daniel McDonald, Hudan Nuch, Stewart Plain and Vernon Topp, and led by Jane Melanie. Valuable contributions to this study were also provided by Joshua Craig, Dominic Crowley, James Hunter, Ralph Lattimore and Marcelo Munoz.

Patricia Scott  
Commissioner

September 2014

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# Terms of reference

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

## **Background**

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

## **Scope of the research study**

In undertaking the study, the Commission should:

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

## **Process**

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

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

The final report will be published.

J B HOCKEY

Treasurer

[ received 7 April 2014]

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# Abbreviations and explanations

## Abbreviations

ANZSIC	Australian and New Zealand Standard Industrial Classification
APVMA	Australian Pesticides and Veterinary Medicines Authority
AQIS	Australian Quarantine and Inspection Service
BLS	The Bureau of Labor Statistics (US)
CODB	cost of doing business
COGS	cost of goods sold
FFIA	Fast Food Industry Award
FSANZ	Food Standards Australia New Zealand
GRIA	General Retail Industry Award
HBIA	Hair and Beauty Industry Award
MFP	multifactor productivity
NAICS	North American Industry Classification System
NCSL	National Conference of State Legislatures
NICNAS	National Industrial Chemicals Notification and Assessment Scheme
NMI	National Measurement Institute
NTC	National Transport Commission
ONS	Office for National Statistics (United Kingdom)
PC	Productivity Commission
PPP	purchasing power parity
TGA	Therapeutic Goods Administration
USCB	United States Census Bureau
WPI	wage price index

## Explanations

Billion	The convention used for a billion is a thousand million ( $10^9$ ).
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# OVERVIEW

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## Key points

- The Australian retail sector comprises more than 133 000 businesses contributing around 5 per cent of GDP and 9 per cent of total hours worked.
- The industry is diverse in terms of firm size, product range, business models and formats, and cost structures. Around 95 per cent of all retail businesses are small businesses. The retail sector is operating in an increasingly dynamic and globalised environment, competing on different platforms and across borders. This has delivered better outcomes for consumers and, combined with shifts in consumer spending, has created a challenging trading environment for many retailers.
- The cost of doing retail business is largely driven by geography, markets and commercial decisions. As such, many of the cost pressures facing retailers are market driven and require commercial responses.
  - That said, there are some costs that are heavily influenced by government regulations such as those affecting trading hours, the supply of retail space, workplace relations, transportation and delivery of goods, utility charges and liquor licensing. These cost pressures are accentuated in an environment where retailing is more competitive.
- As was the case in 2011 when the Commission undertook an extensive inquiry into the economic structure and performance of the Australian retail industry, retailers continue to operate under several regulatory regimes that unnecessarily inflate their costs and restrict their ability to innovate. With the exception of Victoria, reforms since then have been piecemeal, and incomplete across most jurisdictions. Major restrictions that still need to be addressed are:
  - trading hours regulations that restrict the industry's ability to adapt and compete with online competitors, and provide the convenience that consumers expect
  - planning and zoning regulations that are complex, excessively prescriptive, and often anticompetitive.
- Several input prices have increased to add further cost pressures, with prices for major inputs such as labour and occupancy rising faster than final retail prices.
  - Notwithstanding the increase in these input costs, cost structures and retail profits have remained relatively stable at a broad industry level. To some extent, overall profitability has been protected by the lower cost of some goods, reflecting both sourcing strategies by retailers and the appreciation of the Australian dollar. The rise in input costs has also been partly offset by productivity gains in the retail sector.
- While some of the larger retailers monitor costs domestically and compare those to their competitors here and overseas, this information is very tightly held given its commercial sensitivity. There are limited publicly available data to support an international comparison of costs across the wide spectrum of businesses operating in what is a very diverse sector.
- At an industry level, labour costs and rent as a share of revenue appear higher in Australia relative to the United Kingdom and the United States. For some retail categories, such as supermarkets, there are no discernible differences in cost structures between Australian retailers and those operating in broadly comparable markets overseas. For other retail categories, such as clothing and footwear, differences are more apparent.
- While Australian consumers are enthusiastic online shoppers, Australian retailers do not appear to be using online retailing to its full potential.

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# Overview

The retail industry provides a key intermediary service between producers and consumers of final goods. The sector contributes almost 5 per cent to Australia's GDP and 9 per cent to total hours worked in the economy.

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

The cost of doing retail business is largely driven by geography, markets and commercial decisions. As such, many of the cost pressures facing retailers are market driven and require commercial responses. For example, some retailers have the option of moving to online sales platforms in order to reduce their rental and other occupancy costs.

However, there are some costs that are heavily influenced by regulatory settings such as those affecting trading hours, employment conditions, the supply of retail space, the transportation and delivery of goods, utility charges and product labelling. Some of these regulations are specific to the retail sector and some affect the broader economy.

These cost pressures are accentuated in an environment where retailing is becoming an increasingly globalised business and the growth of e-commerce is broadening the geographic reach of competing retailers.

## **What the Commission has been asked to do**

The Australian Government has asked the Commission to undertake a study into the costs of the retail trade industry as part of the Government's broader interest in relative cost structures.

In doing so, the Commission is required to:

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

**Cost of doing business**

The Commission has focused on retailers’ cost of doing business, recognising that there are other costs in getting goods to market that are beyond the scope of this study (figure 1). In particular, this study does not examine costs throughout the entire supply chain, including back to the source country. This would involve examining issues that are beyond the purview of government action in Australia (wage pressures in China, for example, or the impact of government regulation in Japan). As this study is primarily designed to provide insights for considering policy options related to costs at the retail industry level, the Commission has thus focused on those costs of doing business that are amenable to policy action by governments in Australia.

As shown in figure 1, the focus of this study is on the shaded area *retail cost of doing business* — which collectively refers to the range of operating costs incurred by retailers and includes labour costs, rent and other occupancy costs, and other expenses such as marketing, packaging and administration. The cost of goods has only been considered in relation to profitability.

Figure 1      **The value chain for retail goods**



There is a diversity of cost structures across different types of retail businesses reflecting a range of factors, including different business strategies. A priori, this diversity suggests that there is little reason to consider one form of cost structure to be superior to another. Cost structures in themselves do not indicate where policy intervention might be needed. At best, they are informative of the potential scope and scale of impacts of policy changes.

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Further, costs are only a partial indicator of competitiveness. A relatively high cost retailer (say, due to a relatively high level of service quality) can be highly competitive if its revenue is also high compared to other retailers operating in the same market.

## **Costs are inflated by red tape**

The key findings of this study are that the cost of doing business in the Australian retail sector is inflated by unnecessary regulations, and governments' progress to address costly anticompetitive provisions has generally been slow and patchy.

There is a general consensus among stakeholders consulted in the study that many of the reforms put forward by the Commission in its 2011 inquiry report on the *Economic Structure and Performance of the Australian Retail Industry* remain largely unfinished. That report's recommendations focused on areas where governments could remove unnecessary impediments to domestic retailers' ability to respond to the heightened level of competition. Many of its recommendations are matters for the states and territories, though not exclusively — local governments and the Australian Government are also involved.

All jurisdictions have initiated reform processes but few have achieved substantial reform — Victoria stands out as the exception across the various areas identified by the Commission. In some cases, reform processes have progressed to consultation and review stages but no further. In several jurisdictions, the appetite for further reform is weak.

As a consequence, there are still many examples of poorly designed and implemented regulation that are leading to costly outcomes for retailers and consumers. These include the complex patchwork of trading hours restrictions across and within jurisdictions, anticompetitive planning and zoning laws, and other regulatory impediments that are arguably excessive, arbitrary or obsolete.

## **Trading hours restrictions**

Trading hours restrictions arose in response to cultural and social expectations that are decades, and in some cases centuries, old. They are increasingly out of step with changing patterns of work, leisure and shopping as shown by the widespread utilisation of extended shopping hours. Technological developments also allow consumers to shop online 24 hours a day, seven days a week.

Restricted trading hours also impose costs on retailers and the economy more broadly in terms of forgone sales and higher operational and capital costs. Retailers forced to close on Sundays, for example, are prevented from managing their stocks better, especially those of highly perishable goods like fruit and vegetables. More produce is wasted. Increased trading hours would allow a firm to spread its fixed costs over a potentially larger volume

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of sales, leading to lower average costs. An increase in scale may also enable a retailer to adopt a technology with a lower unit cost of operation or provide customers with a wider range of offerings. At a broader level, the deregulation of trading hours in some jurisdictions has been shown to increase employment opportunities in particular segments of the retail sector. The sector is a significant employer and further deregulation of trading hours is likely to benefit particularly the youngest and oldest age cohorts, first time job-seekers, and those with a preference for part-time or casual work.

In recognition of these benefits, the Commission recommended in its 2011 retail report that retail trading hours be fully deregulated in all states, including on public holidays.

The deregulation of trading hours provides greater flexibility to retailers, allowing them to more closely align opening hours with consumer demand. It does not mean that all or even many retailers will trade 24 hours a day, seven days a week. Businesses will open when they consider it is in their commercial interests, and opening hours will reflect consumers' shopping patterns.

Trading hours are effectively deregulated in Victoria, Tasmania, the Northern Territory and the ACT, and largely unrestricted in New South Wales. South Australia, Western Australia and Queensland have the most restricted trading hours, and within each of these jurisdictions there are widespread inconsistencies.

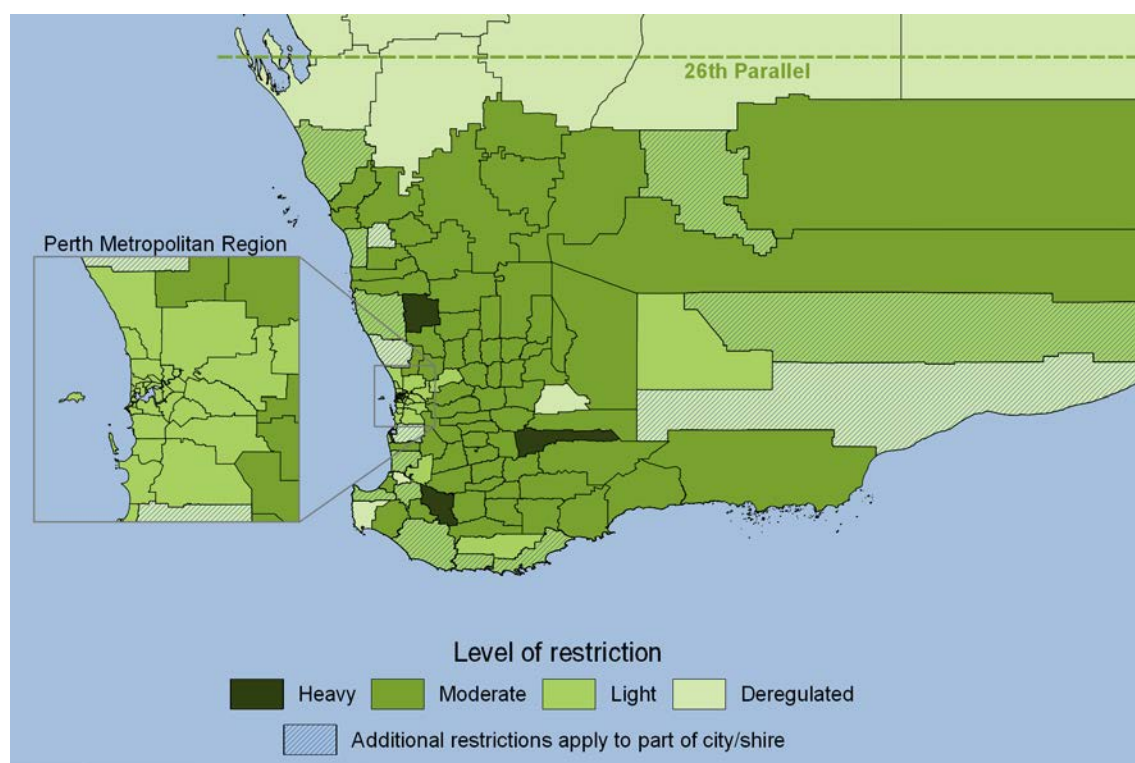
Jurisdictions with the most restricted trading hours have not pressed on with statewide reforms to deregulate retail trading hours since 2011 and instead have mostly adopted a location-specific approach. This piecemeal approach to deregulation has reinforced the patchwork of regulations across and within jurisdictions with consequential distortions and anomalies. While there has been an extension in permissible hours of operation for bricks and mortar retailers in some locations (particularly in city areas), this has increased the variability of location-specific arrangements around the country and sharpened the comparative disadvantage of those retailers and consumers outside the areas where trading hours have been extended.

Jurisdictions to varying degrees restrict trading hours by hour of the day, day of the week, whether it is a public holiday, the geographic location of the shop, its physical size, the number of owners and/or employees and product lines sold. This leads to highly localised and firm-specific trading arrangements within and across jurisdictions, thus increasing complexity and compliance costs for businesses. There are also additional compliance and operational costs to retailers trading in more than one jurisdiction. These costs become more acute around the time of gazetted public holidays, when retailers have to interrupt 'normal' trading arrangements and put in place different arrangements, such as those related to staff rosters, deliveries, cleaning as well as waste and cash collection services, to comply with the diverse public holiday trading arrangements set down in different states, regions and local precincts across Australia.

In Western Australia different degrees of restrictions apply across the state without any obvious coherent policy rationale. Retail trading hours are deregulated north of the

26<sup>th</sup> parallel of south latitude for historical reasons. However, those areas that are regulated have highly localised variations (figure 2). In the Perth metropolitan area, general retail shops have been able to open on Sundays between 11 am and 5 pm since 2012 but cannot trade in regional areas on Sundays unless location-specific exemptions apply. In some cases, these location-specific exemptions have restricted trading hours further, with general retail shops closed after 1 pm on Saturdays in three local government areas (with ‘heavy’ restrictions, in figure 2). In other cases, while trading restrictions have been relaxed in some areas, this only applies to some towns in the local government area, or even specific streets or shopping centres.

**Figure 2      The patchwork of retail trading hours in Western Australia, 2014**



As in several other jurisdictions where exemptions to local trading hours restrictions can be sought through different avenues, local governments in non-metropolitan areas of Western Australia can amend their trading hours where approved by the Western Australian Minister for Commerce. The WA Local Government Association acknowledged that these approval processes may not be subject to an appropriate framework to balance competing interests within their local communities.

In South Australia, Sunday trading hours vary by shop location, size and product range. Stores located outside prescribed zones in Adelaide and regional areas, and/or small shops or shops selling certain goods (for example chemists and nurseries) can trade over

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unrestricted hours. However, larger stores located in the greater Adelaide shopping district that are not exempt by product line can only trade between 11 am and 5 pm on Sundays, while larger stores located outside Adelaide in prescribed shopping districts cannot trade at all on Sundays. In Adelaide, some shops in the central business district can open on public holidays, but shops in the nearby metropolitan area cannot.

In Queensland there are more than 30 separate trading zones. In Brisbane, a highly prescriptive approach results in a wide array of different configurations for the 'Inner City of Brisbane' and specific parts of the Inner City, being 'Area of City Heart of Inner City of Brisbane' and 'Area of New Farm of Inner City of Brisbane', in what is a relatively small geographic area. The Commission has also identified one trading zone in Queensland (Cooloola Cove) that appears to only contain one supermarket.

Restrictions on trading hours lead to reduced consumer convenience and increased travel costs, higher capital costs to deal with artificial peaks in shopping activity, greater product wastage, lost sales with a likely disproportionate negative impact on the visitor economy, and a restricted ability to compete with online retailers. They add complexity to business operations that are not necessary nor in the interest of consumers or the state economies.

The suggestion that shoppers immediately transfer their business to smaller shops is not borne out by the facts. Figure 3 illustrates the inconvenient adjustment of shopping behaviour. In some cases people will travel to other large shops or simply go online.

Woolworths provided an example in New South Wales, where its Shellharbour store is exempt from trading hour restrictions on Boxing Day but other stores (for example, in Wollongong, around 20 kilometres away), are closed. On Boxing Day, the proportion of Woolworths' Shellharbour store revenue from residents outside the store 'catchment' rises to 40 per cent, compared with 20 per cent on a 'typical' day. At least part of this increase is likely to be attributable to Wollongong store customers shopping in Shellharbour on Boxing Day, as they continue to shop on restricted trading days but just have to drive further to get to open shops.

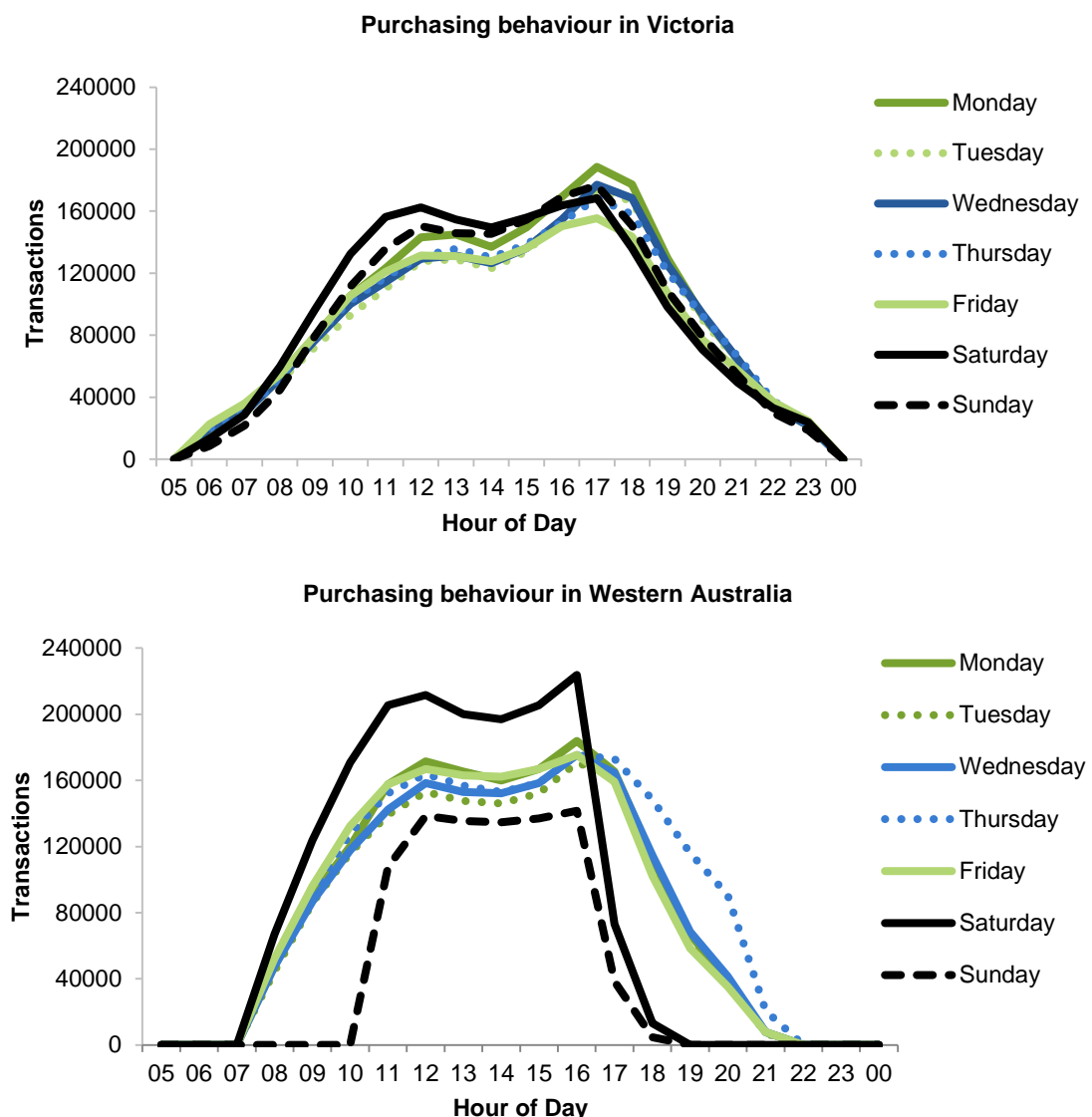
Alternatively, many shoppers go online. In general, there are no trading hours restrictions for online shopping and while currently there can be a price premium for the convenience of online grocery shopping, this cost disadvantage can be expected to dissipate with the development of more flexible and efficient formats, such as 'dark warehouses' dedicated to online sales.

Data presented by the Economic Regulation Authority (ERA) in Western Australia show the extent to which customer behaviour is distorted by the existing retail trading hours in that state. On weekends in particular, there is a strong demand for shopping activity immediately after shops open and another significant peak in shopping activity just before shops close. This situation contrasts with the behaviour observed in the deregulated trading market of Victoria, for example, where shopping activity is more spread out and shopping precincts are less congested (figure 3). The distorted shopping patterns evident in Western Australia lead to more congestion and inconvenience for shoppers.



The ERA also points out that of the 29 jurisdictions in Western Australia that have taken the opportunity to modify their retail trading hours, all have extended their hours and eight have fully deregulated their trading hours. No local government authority has subsequently sought to re-regulate their trading hours in the past 15 years.

**Figure 3 Purchasing behaviour in Western Australia affected by restricted trading hours on Sunday<sup>a</sup>**



<sup>a</sup> Aggregate transactions in Coles stores (10 in Victoria, 10 in Western Australia) over a 12 month period in 2012 and 2013.

Source: Adapted from ERA (2014b).

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In addition to trading hours restrictions, there are arbitrary restrictions on product lines, including rules on what products can be sold at particular times, that impose additional costs on retailers of all sizes from lost revenue and diverting resources to ensure compliance. In many cases, these rules are anachronistic and have no apparent rationale.

For example in Western Australia, regulations prevent Masters Home Improvement stores from trading in line with the hours enjoyed by other hardware stores. To be eligible to trade as a ‘domestic development shop’ Masters must only sell those goods that are prescribed by the Retail Trading Hours Regulations 1988. The regulations prescribe a list of what a ‘domestic development shop’ can sell, which gives rise to all sorts of inconsistencies and anomalies. The regulations allow the sale of:

- light bulbs but not light fittings
- outdoor lighting but not indoor lighting
- kitchen sinks but not dishwashers
- wood-fire heaters but not gas heaters
- indoor television antennae but not outdoor television aerials.

While a number of participants in this study supported further deregulation of trading hours, other participants opposed more liberal trading hours. Some of those participants opposing deregulation argued that it would have a detrimental impact on small retailers. However, the evidence does not support the claim that deregulation of trading hours has a material effect on the structure of the retail sector and the viability of small retailers. By using the participation of small businesses in the market as a metric for competition, trading hours restrictions ignore the potential for more than offsetting gains in terms of the lower cost of doing business and increased consumer welfare in such an economically significant sector.

## **Planning and zoning restrictions**

Occupancy costs account for a substantial share of many retailers’ cost of doing business. Rental costs in particular are largely determined through the interaction of buyers and sellers in the market for retail space, the planning and zoning activities of governments (at state, territory and local levels), as well as laws governing retail tenancy agreements. Hence, government policies cannot be ignored as drivers of retail sector costs.

Planning and zoning systems establish how land can be used and how such uses can be changed. In terms of retail activities, state and territory governments’ planning policies are typically formulated around ‘activity centres’ that seek to deliver net benefits to the community by concentrating retail and other employment activities into specified locations. These policies can be either competition-enhancing or competition-reducing depending on how the policies are designed and implemented by relevant planning authorities.

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A number of submissions to this study and to the ongoing review of competition policy commissioned by the Australian Government have highlighted examples of unnecessarily restrictive approaches to planning and zoning, which are increasing retailers' cost of doing business — both in terms of rent and compliance (see chapter 6).

The Commission and others have thoroughly reviewed planning and zoning issues (including retail tenancy leasing issues) over recent years, and have made substantive recommendations regarding necessary reforms and leading practices.

Two reforms have been identified as being of particular importance: first, the need to reduce the number of business zones and increase the permissible uses of land (to reduce prescriptiveness) within these zones; and second, to remove consideration of the effects on existing individual businesses from the approval process for development applications (to avoid anticompetitive outcomes).

A number of state and territory governments have either conducted reviews of their planning and zoning regimes in recent years, or are in the process of conducting reviews. However, even where reviews have been completed, progress across jurisdictions in implementing change has been inconsistent. Victoria is generally considered to be ahead of other jurisdictions in implementing leading practices for planning and zoning outcomes, while New South Wales has considerable scope for further improvement.

The Victorian Government has reduced the number of business zones and expanded the allowable uses of those zones. It has also reformed and streamlined development assessment processes, with a maximum 10 day decision period for simple applications to the value of up to \$50 000.

The New South Wales Government has completed a major review (White Paper) of its planning and zoning system, including commissioning an external evaluation of the likely net benefits flowing from reforms. The reform options canvassed in the review align with the leading practices recommended by the Commission, and are likely to materially improve planning and zoning outcomes in New South Wales if fully implemented.

However, the draft legislation that is currently before the Parliament of New South Wales is less ambitious compared with the changes canvassed in the White Paper. At the time of writing, the Planning Reform Bill 2014 remains on the agenda for consideration by the New South Wales Legislative Assembly, despite critics of the current system describing it as 'dysfunctional', 'outdated', 'overly complex', 'time consuming', and 'in need of a complete overhaul'.

The Commission is strongly of the view that state, territory and local governments can assist consumers and the retail sector by developing and applying zoning policies that ensure the areas where retailers locate are both sufficiently *large* (in terms of total retail floor space) and sufficiently *broad* (in terms of allowable uses, particularly those relating to business definitions and/or processes). This would allow new and innovative firms to enter local markets and existing firms to expand.

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Expanding the supply of retail space would reduce its cost (relative to what it would otherwise be) and would make retailers more competitive (particularly in the face of growing competition from online retailers) to the benefit of consumers. It would also provide consumers with greater choice and allow retailers to be more flexible in meeting consumer demands.

Effective reform in planning and zoning inevitably needs to involve local governments (where state planning and zoning regulation is largely made operational). Inadequate resources and skills at that level can compromise the effectiveness and efficiency of planning and zoning systems, and make it less likely that state government policies or regulations governing planning and zoning can be implemented consistently or as intended.

Submissions to this study have again raised concerns regarding retail tenancy leases, including the issue of an imbalance in bargaining power between shopping centre tenants and large shopping centre owners. Wider implementation of the leading practices identified by the Commission and others following a 2008 study of the market for retail tenancy space should help to resolve some of these problems. However, the Commission also considers that the root cause of most retail tenancy lease problems are unduly restrictive planning and zoning controls that limit competition and restrict retail space, particularly in relation to shopping centres. Addressing the latter would also resolve many of the problems in the retail tenancy market.

## **Other regulatory burdens**

Although labour and occupancy costs generally constitute the main costs of doing business for retailers, participants also drew attention to other examples of inconsistent, highly prescriptive and seemingly ad-hoc rules and regulations that were imposing unnecessary costs on their business.

Most of these unwarranted costs appear to derive from deficiencies in the regulatory process including:

- the presence of multiple regulators (and, thus, multiple compliance costs)
- poorly developed regulation (with regulation not justified on a cost-benefit basis or compliance costs in excess of those that are ‘efficient’)
- inconsistent regulations between and/or within jurisdictions (with retailers operating in more than one location subject to compliance costs for multiple sets of differing regulations).

Participants provided examples of what they considered to be poorly developed regulation that resulted in excessive compliance costs. These include:

- restrictions on times for delivery and pickup/waste disposal
- liquor licensing regulation in Queensland that requires an applicant to own a hotel before being eligible to receive approval for off-licence liquor retailing

- 
- product labelling, packaging and safety laws that impose unjustified or excessive compliance costs
  - controls on the interstate movement of goods
  - legislated container deposit schemes
  - regulation in Victoria (announced for repeal but not yet repealed) banning the sale of plastic knives to minors.

The Australian Automotive Aftermarket Association's (AAAA) submission to this study highlighted draft regulations in New South Wales that would require a licensed mechanic to fit items such as car floor mats. This requirement would increase the cost of doing business for automotive accessory retailers with no additional benefit to consumer safety. The AAAA observed that these draft regulations (contained in a public Regulatory Impact Statement seeking stakeholders' comment) did not meet the fundamental principle that regulation should only be introduced where the imposed burden does not outweigh the expected benefit.

Subsequent to its submission to this study, the AAAA met with NSW Fair Trading to discuss its concerns with the draft regulations. As a result of those discussions and the Commission drawing this matter to the attention of New South Wales Government officials working on regulatory reforms, the draft regulations are expected to be amended to resolve the AAAA's concerns.

This example highlights the importance of commonsense considerations in formulating regulations, consultation with stakeholders before the draft legislation stage, draft legislation being available for consultation and review, and governments' commitment to this process as standard practice for developing regulations.

Even where regulation is justified and imposes efficient compliance costs, when that regulation differs between and within jurisdictions, retailers operating in more than one jurisdiction incur added compliance costs from the complexity of multiple sets of differing regulation. One example relates to the responsible service of alcohol certification that is not fully transferable across states and territories, irrespective of the amount of experience that a person may have had in the liquor retail sector. This may be an area suitable for harmonisation or mutual recognition if consultation and analysis indicates that the expected benefits of reform are likely to exceed the expected costs.

Harmonisation is easier said than done, given the complexities of aligning different regulatory regimes. As the COAG processes have demonstrated, even relatively simple and uncontentious reforms can take a long time to implement. For example, even a matter as seemingly simple as wine bottle labelling was subject to discussions commencing in the 1990s leading up to the implementation of harmonised standards in 2009. In more complex areas harmonisation can prove both highly contentious and elusive (for example, occupational health and safety).

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In cases where state-specific regulations are well entrenched and involve considerable sunk costs, harmonisation for firms that do not operate across state boundaries may produce minimal gains and can impose net costs. The gains may principally be enjoyed by larger firms operating across Australia but simply add to the costs of firms operating only in one jurisdiction. For this reason, and given the large number of small single-state firms in the sector, it is important that governments subject reform and regulatory proposals to cost-benefit analysis. In some cases, there may be more suitable reform options than harmonisation.

### Regulatory reforms often proceed at a snail's pace

Concerns about deficiencies in the regulatory environment are not new, nor are they confined to the retail sector. They reflect broader concerns about 'good' or best practice regulation.

The Commission's 2011 report on retailing identified similar concerns about regulation, and recommended that governments prioritise efforts directed at the review and reform of existing regulations that are unnecessarily burdensome, and reduce regulatory inconsistency across jurisdictions where it affords net benefits to business and the community.

The Australian Government agreed with the recommendation in-principle, and stated that it would progress reform across jurisdictions through COAG and task the Commission to review, benchmark and report on regulatory issues. Since then, the Commission has assessed the impact of 17 of the 28 COAG business reforms (PC 2012) and benchmarked regulatory impact analysis (2012), the role of local government as regulator (2012) and regulator engagement with small business (2013).

The reforms assessed by the Commission in 2012, including of product safety, occupational health and safety, and food regulation, were agreed to by jurisdictions in 2008 under COAG's National Partnership Agreement to Deliver a Seamless National Economy, which aimed to reduce the regulatory burden on firms operating in multiple jurisdictions. Overall, the Commission estimated the economywide benefits of fully implementing the reforms to be almost 0.5 per cent a year in increased output and around \$4 billion a year in lower business costs. Progress in these reform areas remains patchy and significant effort is required to deliver the estimated gains.

Some jurisdictions are working on reducing red tape for retail businesses. For example, New South Wales is currently undertaking a review into unnecessary regulatory costs that affect the clothing retail sector. The Northern Territory announced in May 2014 that the Civil and Administrative Tribunal will provide retailers with a one-stop-shop for access to dispute resolution facilities and a red tape business advocate as an interface between business and government.

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Nonetheless, the examples raised by participants in this study underscore the need for governments to continue to prioritise efforts directed at the review of regulations that are unnecessarily burdensome and reduce regulatory inconsistencies across jurisdictions where there are net benefits to business and the wider community.

At the local government level, previous work by the Commission found that many councils lack the resources needed to effectively apply state and territory legislation. Addressing concerns about unnecessary or inconsistent regulation at the local government level will require state and territory governments to assume a greater role in building and maintaining local government regulatory capacity.

## **Other cost pressures are increasing**

In addition to unnecessary regulatory burdens imposing costs on retail businesses, a common theme from a number of submissions is that over recent years, prices of labour and intermediate inputs such as rent and energy have risen materially, with varying impacts on different retailers. For example, energy price rises would have had a more substantial impact on costs for retail businesses that require refrigeration for their products, whilst providing a stronger incentive for these businesses to invest in energy saving measures.

The data suggest that several major input prices have indeed risen faster than final retail prices and that final retail prices have grown more slowly than overall price levels in the economy as measured by the consumer price index.

Notwithstanding the observed increase in several input costs, the cost structure at the industry level has not changed fundamentally over the past decade (figure 4, left panel), with labour and intermediate inputs continuing to comprise the majority of the cost of doing business.

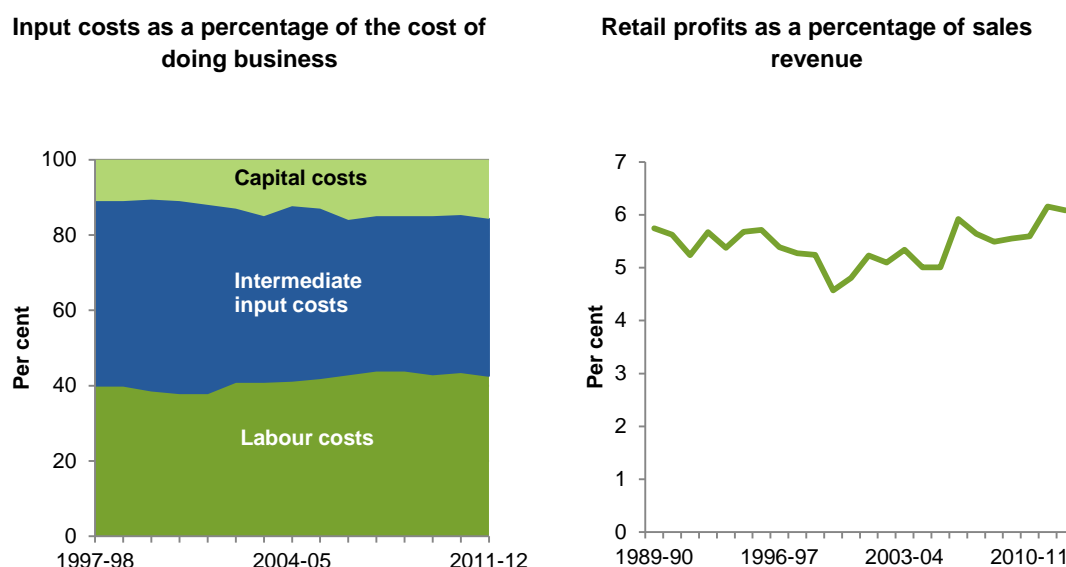
Similarly, retail profits have also been relatively stable at an aggregate level (figure 4, right panel). To some extent, profits have been protected by the lower cost of some goods — reflecting both sourcing strategies by retailers and the dampening impact of a relatively strong Australian dollar on the cost of imported goods (figure 5). Productivity gains in the retail sector, both in terms of labour productivity and multifactor productivity, have also partly offset the increases in input costs faced by retailers.

Growth in labour productivity and in multifactor productivity (MFP) in the retail industry have been considerably stronger than in the market sector over the past five years. However, Australia's market sector MFP growth has been poor over the past decade when compared with long term MFP growth.

While the aggregate picture shows relatively stable cost shares and profitability, it is likely to be skewed by the dominant areas of retail (such as food and grocery). At a disaggregated level, the performance of individual retailers can be expected to vary as a reflection of market conditions and commercial decisions by individual retailers. For example, the

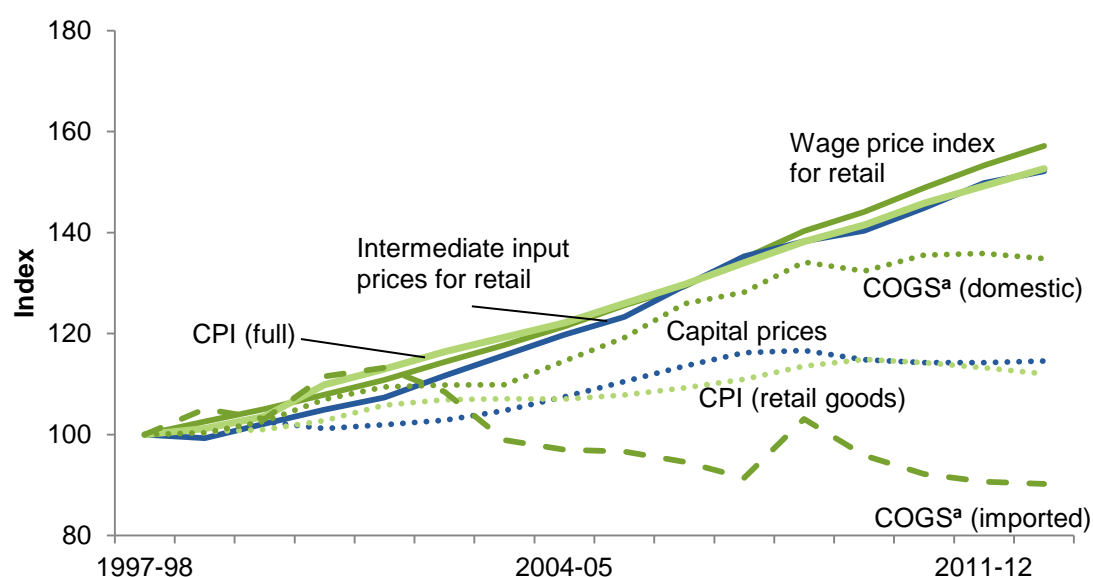
average profit margin for food retailing was 6.3 per cent in 2012-13. This compares with a 4.8 per cent profit margin for other store-based retailing which includes clothing and footwear, household furnishings and other goods of a more discretionary nature.

**Figure 4 Cost structure and profit margins are relatively stable**



**Figure 5 Labour and intermediate input prices have increased relative to capital prices and final retail prices**

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



<sup>a</sup> COGS denotes the 'cost of goods sold', which represents prices paid to manufacturers for retail goods.



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## Labour costs

The total cost of labour to a retail business comprises — in addition to base wages — any above-award rates of pay and overtime, penalty rates and loadings, other allowances and non-monetary entitlements (such as staff discounts, which are common in retail), the costs of hiring, firing and training and labour ‘on-costs’ (such as payroll tax, workers compensation insurance premiums and employer superannuation contributions).

Labour costs are the single largest area of expense for most retail businesses, whether based in Australia or elsewhere. In 2012-13 labour costs represented 47 per cent of the cost of doing business in the retail sector. While the share of labour costs has remained relatively stable as a proportion of the cost of doing business, there is considerable variation around the average in cost structures for different retail categories, reflecting different business models.

Many stakeholders stated that labour costs in the retail sector are high relative to other countries and that these costs have increased substantially in recent years. Submissions to the study have canvassed a range of issues related to labour costs including the general level of wages in the sector, the growth in wages, penalty rates and labour on-costs. Several submissions compared Australia’s wage costs to those overseas. In pinpointing the sources of wage differentials, stakeholders identified several workplace regulations as particularly important — including higher minimum wages and penalty rates.

## Wages and earnings

Employees in the retail industry earn less on average than those in most other industries, reflecting the relatively low skill levels required for the majority of retail positions. Among full-time adult employees, average weekly earnings (which include ordinary time earnings, penalty rates and on-costs such as employer paid superannuation) in the retail sector were around 70 per cent of the average across all industries in May 2014.

In 2012, nearly 26 per cent of retail employees were reliant on the *General Retail Industry Award 2010* (‘the retail award’), making it relatively more award-reliant compared to the average across all industries (16 per cent). Around 72 per cent of retail employees were covered by collective enterprise or individual agreements.

Over the period from 2008 to 2012, average annual growth in retail wages (in terms of average weekly total cash earnings for all methods of setting pay) was 3.8 per cent for the retail industry and 4.3 per cent for all industries.

## International comparisons

The terms of reference ask the Commission to identify areas of cost advantage and disadvantage that Australian retail businesses face relative to international competitors, where relevant. The Commission has taken this to refer to competition from retailers

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operating overseas who are directly servicing Australian consumers through online platforms and not international companies that have set up retail operations within Australia.

For some retailers, international online competition may not be much of a threat at present — partly because they enjoy the protection that comes from the nature of the goods (for example, perishability or lack of homogeneity or compatibility) and from relatively high international freight charges. For other retailers already facing online competition (or the threat of online competition) relative costs are one important element in determining their competitiveness. For the Australian economy overall, inflated costs in the retail sector also impact on the other sectors of the economy (in terms of resource allocation and higher prices).

International cost comparisons for the retail sector, including of labour costs, are fraught with difficulty. Data limitations, including the perennial issues associated with converting costs into a common measure, raise inherent comparability issues in an industry as diverse and dynamic as retail trade.

The choice of comparator countries is, for the most part, limited by data availability. For this analysis, most comparisons have been drawn between Australia, the United Kingdom and the United States, although comparisons with other countries have also been cited where available. The United Kingdom and the United States are considered to be broadly comparable to Australia, as they have similar economic structures and consumer preferences, and given the presence of international retailers that operate across all three countries. These countries are also of particular interest given their prominence in global online retailing.

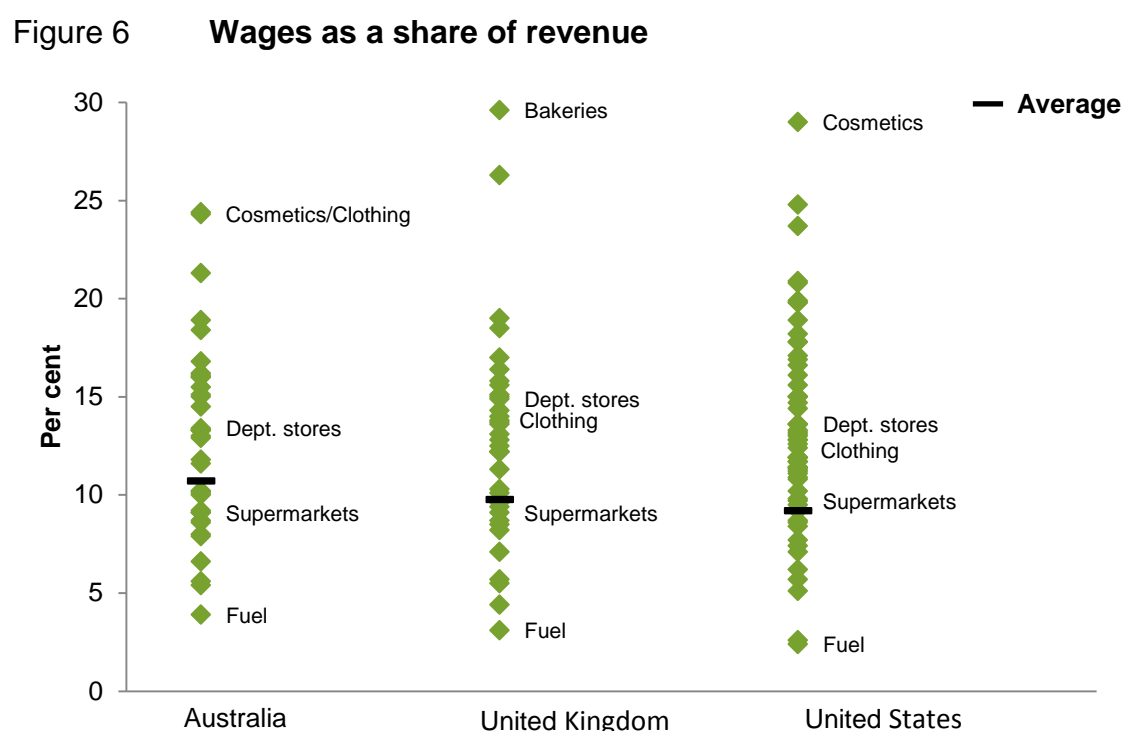
A comparison of total hourly labour costs for retail trade suggests that Australia has relatively high costs relative to the United Kingdom and the United States in Australian dollar terms, but is comparable to countries such as Germany and the Netherlands. However, this needs to be set against the appreciation of the Australian dollar against major currencies in recent years.

Any cross-country comparison of labour costs also needs to take into account how much output is produced relative to labour costs. A retail worker in one country may cost more per hour to employ, but may also be more productive. As such, crude expressions of wage rates per hour are not particularly insightful. A more relevant measure is ‘unit labour costs’, defined as average labour costs (including wages, entitlements and on-costs) as a proportion of a given unit or measure of output (ideally in gross value added terms). These ratios also have the benefit that they are not influenced by exchange rate volatility.

Given the diversity across the retail sector, there is substantial variation in such ratios across and within retail subsectors. This suggests that a meaningful comparison of unit labour costs would therefore require firm-specific data for comparable retailers — which are not available in the public domain.

At an aggregate level, labour costs as a share of revenue (which can be considered as a proxy for unit labour cost) are higher in Australia than in the United Kingdom and the United States. The Commission has also drawn on the disaggregated data available from IBISWorld for a selection of retail segments in these countries. The data highlight the considerable variation in the ratio of wages to revenue across different retail categories. For some segments, such as supermarkets, there are no major differences in the share of labour costs, or in cost structures more broadly, between Australian retailers and those operating in comparable markets overseas. Nonetheless, there are some sectors, such as clothing and footwear, where labour costs ratios appear substantially higher.

Figure 6 shows the dispersion of wages (which account for the bulk of labour costs) as a percentage of revenue across a selection of retail categories in Australia, the United States and the United Kingdom. The data suggest a relatively narrower range of wages to revenue ratios in Australia, notwithstanding that this can be expected to vary over time. However, across all three countries labour costs tend to be proportionally higher where there are higher levels of service, there is a need for staff with specialised skills or there is a significant degree of product transformation by retailers.



Source: IBISWorld Industry reports 2013, 2013-14, 2014.

Unit labour costs should not be interpreted as a comprehensive measure of cost competitiveness and, though important, should also be considered alongside changes in the cost of capital and of other inputs such as retail space.

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Further, the Commission considers that the retail sector's labour market cannot be viewed in isolation from the rest of the economy. During consultations, many participants noted the forthcoming inquiry into Australia's workplace relations framework (to be conducted by the Commission) as a more appropriate forum to raise labour cost issues. The Commission agrees with this view.

## **Occupancy costs are also substantial**

Occupancy costs also account for a substantial share of many retailers' cost of doing business in Australia. These are the costs associated with maintaining a shop space and generally include rent (base and turnover) and other fees including fit out costs and shared expenses relating to security, cleaning, electricity, marketing, and insurance.

The significance of these expenses varies across types of retailers and according to their location. As a percentage of the cost of doing business, supermarkets and department stores (who tend to be anchor tenants in shopping centres) and other large format stores such as hardware and building supplies (who tend to locate outside of prime real estate areas) tend to pay proportionally lower rent compared to smaller specialty stores such as clothing and footwear outlets, bookstores and jewellery shops (who tend to locate in prime shopping strips or in shopping centres). As expected, the highest ratios of occupancy costs to retail turnover are generally observed in central business districts and major regional centres.

Differences in rent reflect a number of factors including land and property prices, retail profitability, and the relative bargaining power between landlord and tenant. Occupancy costs are also important points of difference between bricks and mortar and online retailers, with rental expenses generally lower for the latter.

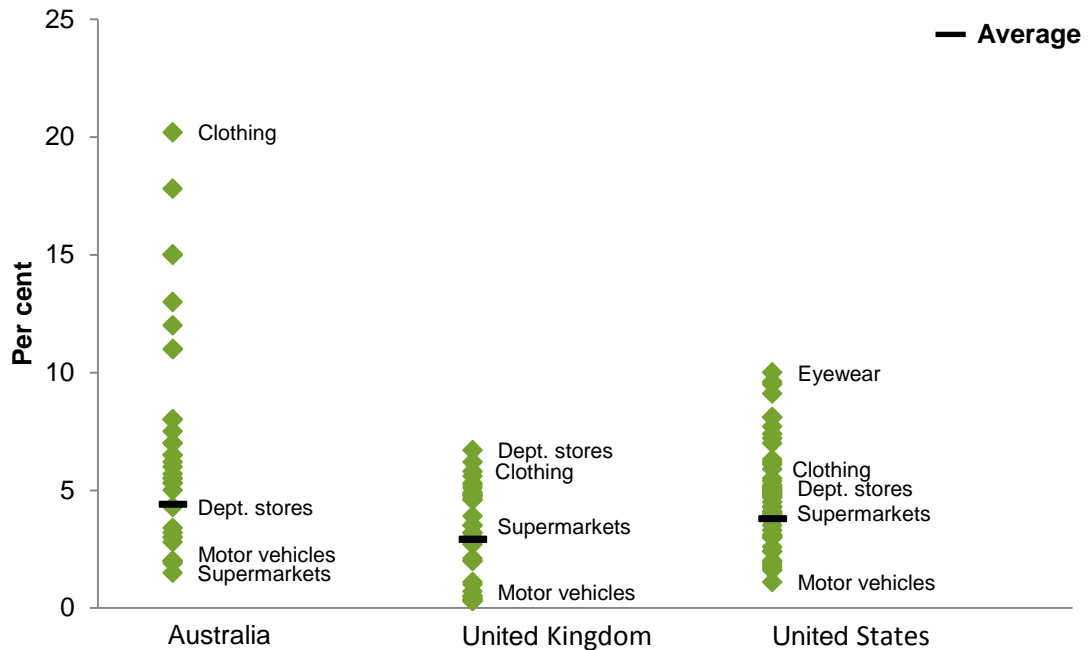
Some participants have suggested that rents in Australia have been relatively stable in recent years. However, there are other participants who have argued that their rents have increased substantially. In relative terms, rent as a share of revenue is higher in Australia compared to the United States and the United Kingdom at a broad industry level (figure 7). Another general observation is that the dispersion of rent to revenue ratios is much wider in Australia relative to these two countries. For some retail categories such as clothing, footwear and furniture, the share of rent is substantially higher than both the industrywide Australian average, and their broadly comparable categories in these two countries.

A number of factors can drive differences in rent cost ratios across countries. These include differences in the quality of retail assets and their location, the regulatory and planning environment in which they operate and the significance of online retailing.

What appears to be clearer is that occupancy costs other than rent have risen in recent years. The Shopping Centre Council of Australia, for example, reports that from 2009 to 2013 per square metre of shop space, the following costs have risen — electricity

(by 36 per cent); insurance (by 34 per cent); air conditioning (by 21 per cent); cleaning (by 19 per cent); and repairs and maintenance (by 13 per cent).

**Figure 7 Rent as a share of revenue**



Source: IBISWorld Industry reports 2013, 2013-14, 2014.

## Retailers are responding

The cost pressures on retail businesses are intensifying in an environment where retailers are operating in a dynamic and globalised environment, competing on different platforms and across borders. Further, an increasing number of high profile international players are investing in a bricks and mortar presence in the Australian retail market. While these have delivered better outcomes for consumers, they have also increased competitive pressure on some retail businesses.

Technological, social, economic and demographic factors are changing consumer preferences and their behaviour. The uptake and development of e-commerce is creating opportunities for retailers through different and evolving formats ranging from ‘pure-plays’ (online only) to ‘bricks and clicks’ (with both an offline and online presence). However, it is also challenging traditional business models and the conventional tradeoff between price and convenience. Price, convenience and product range are driving an increasing number of shoppers online through various digital sales platforms. The data suggest that three quarters of Australian internet users purchased or ordered goods or services online in

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2012-13. Of those who shop online, around 30 per cent are estimated to make online purchases on a weekly basis.

Given its disparate nature in terms of size, product range, business models and cost structures, different retail businesses are facing different levels of competitive pressure. This diversity also means that retail businesses differ in their capacity to respond.

### **... with mixed outcomes**

As a whole, the retail sector appears to be managing rising cost pressures effectively, judging by the relatively stable profit margins over time. There has been some growth in investment and employment in recent years, even though both capital expenditure and the number of persons employed are yet to return to levels seen prior to the global financial crisis.

Many retailers are innovating and adopting a range of strategies to reduce their costs and increase their revenues through the use of technologies such as self-assisted checkouts, a shift from casual to permanent staff, better supply chain management, the use of private label merchandise, energy saving measures, and a move to omni-channel retailing. The more innovative businesses are leveraging big data from in-store sales, online behaviour and social media to predict shopper behaviour and offer more personalised shopping experiences.

Some retailers are striving for non-price points of difference based on a combination of service, quality of goods, convenience and range. Some supermarkets, for example, are moving into new formats — offering sushi bars, barista coffee, cafes with free Wi-Fi and a larger range of take-away/convenience foods. There are also examples of newsagents diversifying into new markets including parcel delivery and other e-commerce activities.

However, the capacity of retail businesses to respond to cost pressures through cost-cutting and other strategies appears mixed.

While growth in total retail sales has slowed since 2008-09, some subsectors have performed more strongly than others. For example, over the past decade, growth in retail turnover in the household goods, and clothing and footwear subsectors has outpaced growth in department store retail turnover. Sales at department stores have been particularly affected by the economic environment, low consumer confidence and heightened competition from specialty retailers and online retailers.

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

Some strategies used to deal with cost increases are better suited to larger retailers or retailers with significant financial backing. They include operating at a loss for the first several years while growing the business; or transformative strategies involving large capital outlays.

Figure 8 **Australia's relative performance in online retailing**



<sup>a</sup> Execution refers to the provision of information and the facilitation of purchase transactions online. <sup>b</sup> Engagement comprises relational and social interaction with customers across social media, forums and a retailer's own digital spaces.

Source: adapted from Riemer et al. 2014.

One option open to businesses of all sizes to varying degrees is to move more of their operations online. In many ways, e-commerce is levelling the playing field for retailers of all sizes by enabling them to access markets that were previously out of reach, while at the same time potentially reducing their labour and occupancy costs. However, this option suits some retailers better than others.

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There is also a question about whether Australian retailers are using online platforms to their full potential. A recent study found that 38 per cent of Australian retailers assessed could be considered as ‘digital commerce laggards’. It suggests that while Australian retailers’ online presence provides for basic online purchasing and product information, Australian retailers are generally lagging international industry leaders in effective online engagement with customers through social media, forums and retailers’ own digital spaces (figure 8).

## What governments can do

Beyond establishing a stable macroeconomic environment, governments at *all* levels can best assist retailers and the broader community by ensuring that the retail sector is open and competitive, and has the capacity to adjust quickly and efficiently to changes in technologies, the development of new goods and services, and changes in customer tastes and preferences. A vibrant retail sector is one where the dynamics of competition leads successful firms to grow and unsuccessful firms to exit.

Several of the major cost drivers faced by retailers are not amenable to policy, but are simply the product of commercial decisions made in functioning markets. On the other hand, some important costs *are* influenced by government policies and regulations. The latter include Australian Government policies on industrial relations, and state and territory government policies on trading hours and planning and zoning. The capacity of local governments to sensibly apply state government regulations is also an important factor in relation to retailers’ cost of doing business, particularly in relation to regulatory compliance.

Addressing deficiencies in the regulatory environment such as those related to trading hours and planning and zoning has the potential to lower retailers’ costs over time, create a more competitive and sustainable sector, and ultimately benefit consumers through greater choice and affordability.



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# Findings

## The Australian retail industry

### FINDING 2.1

Largely reflecting the economic climate, growth in retail turnover has been slow over the past five years compared to the five years prior. Performance has been mixed across the sector with growth in turnover particularly weak for department stores.

### FINDING 2.2

Growth in labour productivity and in multifactor productivity (MFP) in the retail sector have been considerably stronger than in the market sector over the past five years. However, Australia's market sector MFP growth has been poor over the past decade when compared with long term MFP growth.

### FINDING 2.3

E-commerce is creating an increasingly global retail market, broadening the geographic footprint of competing retailers and giving more choice to consumers. Online retailing accounts for a small but growing proportion of total retail trade (around 6 per cent). For certain subsectors, online sales represent a significant share of total sales (for example, entertainment media and clothing). However, for other subsectors (such as food), online retailing is a relatively small proportion of total sales.

## Cost structures

### FINDING 3.1

Although there is significant diversity in cost structures across areas of retail trade, labour and occupancy costs tend to be the single largest costs of doing business. Broad shares of retailers' cost of doing business have been relatively stable over time.

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#### FINDING 3.2

For retail businesses, labour and intermediate input prices appear to have risen in line with inflation but faster than retail prices.

#### FINDING 3.3

At a broad industry level, retail profit has been relatively stable over time. To some extent, overall profitability has been protected by the lower cost of some goods, reflecting both sourcing strategies by retailers and the appreciation of the Australian dollar. Rising input costs have also been partly offset by productivity gains.

## International cost comparisons

#### FINDING 4.1

There are limited cross-country data on cost structures in the retail sector. On average, cost structures in the retail sector appear broadly comparable across countries, with labour costs accounting for the largest share of the cost of doing business.

At a more disaggregated level, for some retail categories, such as supermarkets, the available data suggest that there are no major differences in cost structures between Australian retailers and those operating in broadly comparable markets in the United Kingdom and the United States. However, for some other retail categories, such as clothing and footwear, differences in cost structures are more apparent. The underlying drivers of these differences are not obvious.

#### FINDING 4.2

On average, the ratio of wages to revenue (a proxy for unit labour costs) is higher in Australia compared to the United Kingdom and the United States. While this ratio varies considerably across different types of retailers, there is relatively less variability in Australia. On the basis of limited available data, labour costs to revenue ratios appear notably higher for clothing and footwear retailers operating in Australia.

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#### FINDING 4.3

On average, occupancy costs (including rent) as a share of revenue are higher in Australia compared to the United Kingdom and the United States. While this ratio varies considerably across different types of retailers, there is relatively more variability in Australia. On the basis of limited available data, rent to revenue ratios appear notably higher for clothing, footwear and furniture retailers operating in Australia.

## Trading hours restrictions

#### FINDING 5.1

Trading hours restrictions arose in response to cultural and social expectations that are decades, and in some cases centuries, old. They are increasingly out of step with changing patterns of work, leisure and shopping as shown by the widespread take-up of extended shopping hours, and technological developments that allow consumers to shop online 24 hours a day, seven days a week.

#### FINDING 5.2

The deregulation of trading hours is expected to increase economic activity and lower retailers' cost of doing business. It would also increase choice and convenience for consumers. Further, it could enhance employment opportunities particularly for younger and older workers and those working part-time or on a casual basis.

#### FINDING 5.3

The arbitrary boundaries and exemptions which are a feature of retail trading hours particularly in Queensland, Western Australia and South Australia lead to unintended consequences and anomalies which can disadvantage businesses of all sizes. For example, artificial restrictions on product lines, which in many cases are anachronistic and have no apparent rationale, can impose additional costs on retailers from lost revenue and the diversion of resources to compliance.

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#### FINDING 5.4

Despite the partial changes since 2011 in South Australia and Western Australia, retail trading hours restrictions continue to impose costs on retailers and reduce consumer welfare. There is evidence of the benefits of reform from state regulatory review agencies. The main impediment to deregulation appears to be a lack of political commitment, a significant driver of regulatory policy reform.

## Planning and zoning

#### FINDING 6.1

The Australian economy would benefit from further simplifications to state and territory planning and zoning schemes that expand the supply of retail space by simplifying business zones and removing unnecessary restrictions on the allowable use of land within each zone. Victoria is leading the way in this space, and should serve as a model for other states and territories to follow.

#### FINDING 6.2

The expected net benefits to the economy from state and territory government planning and zoning reforms will only be realised in full if local governments have the resources to effectively implement state and territory government policies consistently and as intended.

#### FINDING 6.3

The core problems in the market for retail tenancy leases will not be overcome until state and territory governments address the issue of planning and zoning controls that unduly limit competition and restrict the availability of retail space, particularly in relation to the supply of retail space in shopping centres.

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## Other regulatory burdens

### FINDING 8.1

There is considerable variability in the regulations adopted by states and territories in relation to the retail sector to achieve broadly the same objective, for example in relation to signage, display and licensing of tobacco products and liquor. This increases compliance costs for retailers operating in multiple jurisdictions.

### FINDING 8.2

In cases where state-specific regulations are well entrenched and involve considerable sunk costs for many retailers, regulatory harmonisation for firms that do not operate across state boundaries may produce minimal gains and impose net costs. The gains may principally be enjoyed by larger firms operating across Australia. For this reason, and given the large number of small single-state firms in the retail sector, it is important that governments subject reform and regulatory proposals to cost-benefit analysis. There may be more suitable reform options than harmonisation.

### FINDING 8.3

Many councils lack the resources needed to effectively apply state and territory government legislation. Addressing concerns about unnecessary or inconsistent regulation at the local government level will require state and territory governments to assume a greater role in building and maintaining local government regulatory capacity.



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# 1 Introduction and scope

The retail industry provides a key intermediary service between producers and consumers of final goods. The sector contributes almost 5 per cent of GDP and 9 per cent of total hours worked in the Australian economy.

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

## 1.1 What the Commission has been asked to do

The Australian Government has asked the Commission to undertake a study into the cost structures of the retail trade industry as part of the Government's broader interest in relative cost structures.

In doing so, the Commission is required to:

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

## 1.2 Scope of the study

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

Under the Australian and New Zealand Standard Industrial Classification (ANZSIC), the Retail Trade Division (G) comprises several subdivisions (box 1.1).

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### Box 1.1      **Retail Trade Division**

Under the ANZSIC definition, retail trade encompasses the following subdivisions:

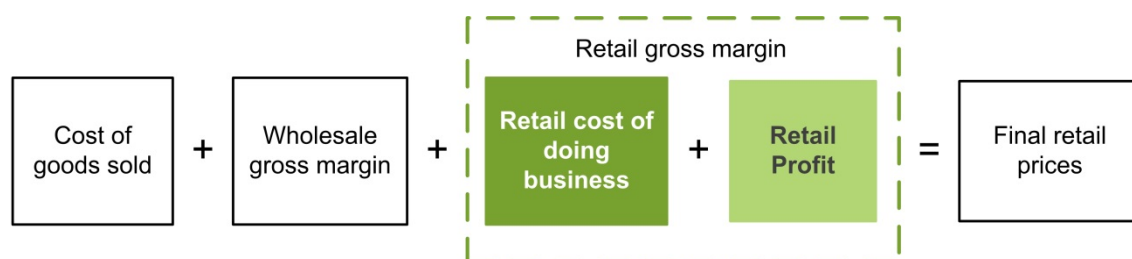
- motor vehicle and motor vehicle parts
- fuel
- food
- other store based retailing, including:
  - furniture, floor coverings, housewares and textile goods
  - electrical and electronic goods
  - hardware, building and garden supplies
  - recreational goods
  - clothing, footwear and personal accessory
  - department stores
  - pharmaceutical and other store based retailing
- non-store retailing and retail commission-based buying and/or selling (businesses engaged in retailing without a shopfront or physical store presence).

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

- the cost of goods themselves
- the wholesaler's margin (cost of doing business plus profit), where relevant
- the retailer's cost of doing business
- the retailer's profit.

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**Figure 1.1      The value chain for retail goods**



There is a range of cost factors affecting the retail industry — some are driven by geography (such as transport costs) and market conditions (such as the cost of goods) while others are determined by the decisions of individual retail businesses (for example, decisions about the use of multi-channels and pricing strategies). However, there are some



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cost drivers that are heavily influenced by regulatory settings — some specific to the retail sector and some affecting the broader economy.

As this study is primarily designed to provide insights for considering policy options related to costs at the retail level, the Commission has focused on those costs that are amenable to policy action by governments in Australia. The cost of doing business collectively refers to the range of operating costs incurred by retailers and includes labour costs, rent and other occupancy costs, and other expenses such as marketing, packaging and administration. While the cost of goods accounts for a significant share of final retail prices, the Commission considers that an examination of issues associated with the cost of goods is beyond the scope of this study (box 1.2). The cost of goods has only been considered in relation to profitability.

The Commission also notes that costs are only a partial indicator of competitiveness. A relatively high cost retailer (say due to a relatively high level of service) can be highly competitive if its revenue is also relatively high compared to other retailers operating in the same market.

#### **Box 1.2      The cost of goods: excluded from this study**

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

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

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

### **1.3      The Commission's approach**

The main objective of this study is to examine the cost structures facing the Australian retail industry, with a focus on both trends and levels where data are available. A secondary objective is to identify how these costs compare with those incurred by international competitors, where relevant. The Commission has taken this to refer to competition from retailers operating overseas who are directly servicing Australian consumers through online platforms and not international companies that have set up retail operations within Australia.

The paucity of published data on costs and the reticence of retail businesses to provide what is essentially commercial-in-confidence information about their costs has led the

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Commission to draw on an assortment of evidence in providing a picture of cost structures and their drivers. Given the diversity of the retail sector in terms of size, product range and business models, costs structures differ markedly across different retailers. Therefore, caution is needed in interpreting aggregate industry data as representative of all individual retail businesses.

There is some value in international comparisons of retailers' costs of doing business, notwithstanding the inherent comparability issues raised. For some retailers, international online competition may not pose much of a threat at present — partly because they enjoy the protection that comes from the nature of the goods (for example, perishability or lack of homogeneity or compatibility) and from relatively high international freight charges. For other retailers already facing online competition (or the threat of online competition), relative costs are one important element in determining their competitiveness.

International cost comparisons can sometimes identify rigidities or inefficiencies. However, this requires going beyond a comparison of cost levels per se to the source of the differentials. Further, costs are typically determined more broadly across the economy and cannot be looked at simply through a retail sector lens. These issues, combined with the disparate nature of the retail sector and data limitations, suggest that international cost comparisons should be interpreted cautiously.

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

## **1.4 Conduct of the study**

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

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

The Commission also held discussions with individual retailers, relevant peak organisations, government agencies and industry analysts (appendix A).

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The Commission released an interim report on 6 June 2014 and invited further public submissions to comment on the material in the interim report and on issues raised by the study. Following the release of the interim report, the Commission held further meetings with interested parties.

At the time this report was finalised, the Commission had received 42 public submissions (appendix A), which are available on the study's web page.

## **1.5 Structure of the report**

Chapters 2 and 3 provide a snapshot of the Australian retail industry and an outline of cost structures and their drivers, respectively. Chapter 4 provides cross-country comparisons of retailers' cost of doing business.

The remainder of the report is organised around specific issues affecting the retail sector's cost of doing business:

- trading hours restrictions (chapter 5)
- planning and zoning restrictions (chapter 6)
- labour costs issues (chapter 7)
- other costs and regulatory burdens (chapter 8).

Finally, appendix A lists the public consultations (submissions and meetings) and supplementary information that the Commission drew on in compiling the study.



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## 2 Snapshot of the industry

### Key points

- In 2012-13, the retail industry generated \$69.7 billion in economic output, and contributed 4.9 per cent to gross value added. In 2013-14 the sector contributed around 8.9 per cent of all hours worked in the Australian economy. However, the industry's contribution to the overall economy has been declining slightly over the past decade.
  - With around 133 375 businesses in operation, the industry is large and diverse — business size, business models, types of products sold and cost structures vary.
  - Around 95 per cent of all retail businesses are either non-employing or have 1-19 employees.
  - Performance varies across retail subsectors, with some subsectors — such as household goods or clothing and footwear — experiencing stronger sales growth in recent years compared to other subsectors, such as department stores.
  - Some sectors of the Australian market are facing increased competition from international bricks and mortar entrants.
- As in other parts of the world, economic, social, demographic and technological factors are changing consumer preferences and shopping patterns.
- An increase in the household saving ratio, combined with relatively less spending on retail products (and more on services) and consumers seeking greater value for money, is creating a challenging environment for many retailers.
- The Australian retail sector is operating in an increasingly dynamic and globalised environment, competing on different platforms and across borders. This has delivered better outcomes for consumers.
- E-commerce is creating an increasingly global retail market, broadening the geographic footprint of competing retailers and giving more choice to consumers. Online retailing accounts for a small but growing proportion of total retail trade (around 6 per cent). For certain subsectors, online sales represent a significant share of sales (for example, around 15 per cent of entertainment media retail sales and 7 per cent of clothing retail sales occurred online in 2012-13). However, for other subsectors (such as food) online retailing is relatively small as a proportion of total sales (1.3 per cent).
- While Australian consumers are enthusiastic online shoppers, Australian retailers do not appear to be using online retailing to its full potential.
- Growth in labour productivity and in multifactor productivity (MFP) in the retail sector have been considerably stronger than in the market sector over the past five years. However, Australia's market sector MFP growth has been poor over the past decade when compared with long term MFP growth.

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## 2.1 Retail in Australia

### A diverse industry

The retail industry provides a key intermediary service between producers and consumers. It enables consumers to purchase items in user-friendly quantities at a convenient time and location. Retailers also often provide a service both pre and post purchase, by enabling consumers to search for, discover and learn about a wide range of goods, and by providing after-market services for customers.

The scope of the retail industry is broad (box 1.1). Given this diversity, it is unsurprising that retailers vary substantially in terms of business size, business models, product range and cost structures.

Food retailing accounts for around 48 per cent of total retail turnover (or \$108.2 billion in 2013-14) (figure 2.1). Of food retailing, the bulk of turnover is from supermarkets and grocery stores. Household goods retailing accounts for around 19 per cent of total retail turnover.

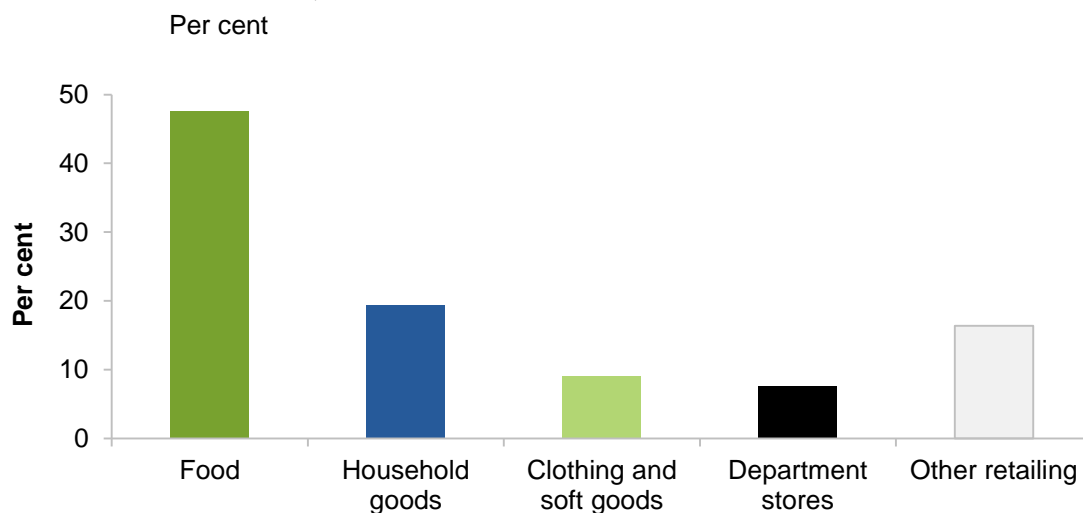
Australian retailers range from sole-operators to businesses that are large by global standards, operate multiple retail outlets and employ a large workforce. Around 95 per cent of all retail businesses are either non-employing or have 1–19 employees (ABS 2014e). Of food retailing businesses in operation at June 2013, 33 per cent were non-employing, 60 per cent had a workforce of 1–19 employees, 7 per cent had 20–199 employees and about 0.2 per cent of businesses employed 200 or more people (ABS 2014e).

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

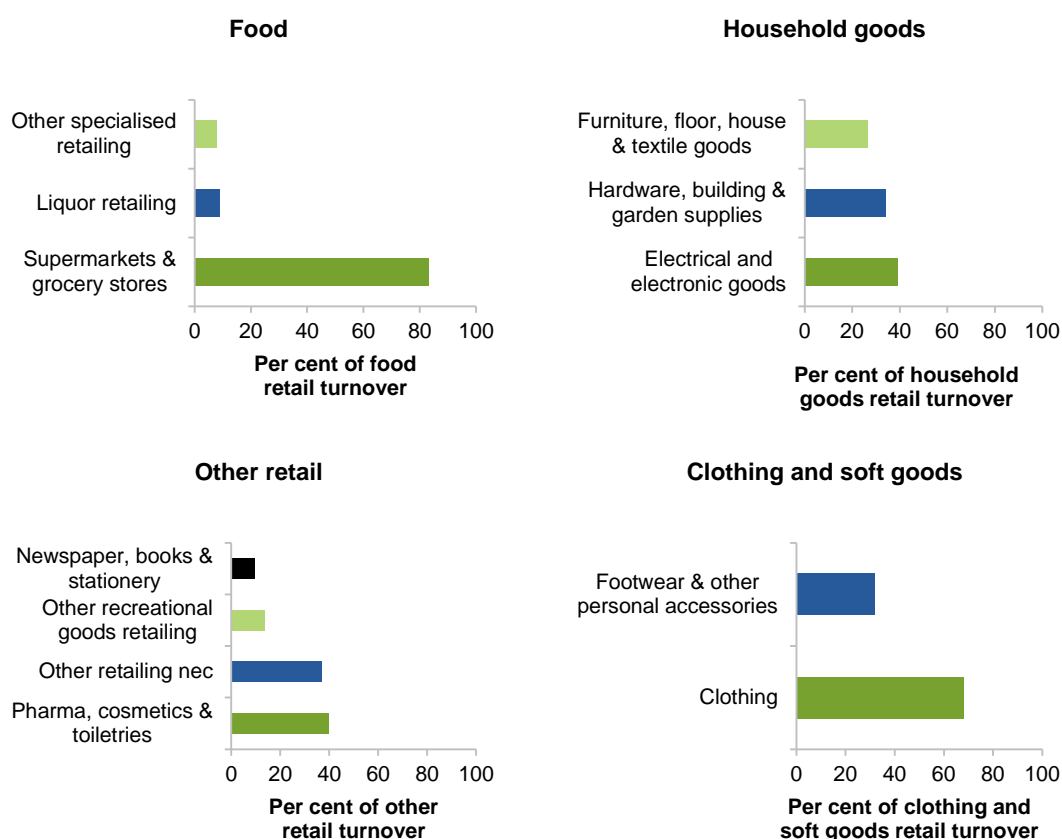
As with most industries, there is significant entry and exit. From 2009-10 to 2012-13, the exit rate was around 15 per cent each year, while the entry rate fell from 17 per cent in 2009-10 to about 9 per cent in 2012-13. Of those retail businesses operating in June 2009, 41 per cent had exited the industry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

In certain retail subsectors, and particularly in urban centres such as Melbourne, international retailers are seeking to establish a bricks and mortar presence in Australia (City of Melbourne, sub. 3). International brands such as H&M, TopShop, Zara, Daiso, and Costco have sought growth opportunities outside their local markets and have been attracted to Australia by factors such as relatively high disposable incomes and stable political and legislative arrangements (Deloitte 2013b). Their entry suggests that the Australian retail market is attractive for international retailers.

**Figure 2.1 Food accounts for the greatest proportion of total retail turnover<sup>a</sup>, 2013-14**



### Proportion of retail turnover by subsector



<sup>a</sup> Excludes motor vehicles and motor vehicle parts retailing and fuel retailing. Estimates calculated from current price data.

Source: Commission estimates based on ABS data (Cat. no. 8501.0, 2014).

## Retail policy and regulation crosses multiple levels of government

Multiple levels of government are involved in retail policy formation and the regulation of the Australian retail industry. Some retail policy issues come under the purview of the Australian Government, such as import taxation and duties on retail goods, competition policy, and industrial relations.

In many cases, policy making and regulation affecting the retail industry is the responsibility of state and territory governments, for example, in the case of retail trading hours (chapter 5). Local governments are also involved in some retail issues, such as road access, planning and zoning (chapter 6), and food safety. Often, regulations set at a state level are made operational at local government levels.

## 2.2 Retail plays an important role in the economy

In 2012-13, the retail industry produced \$69.7 billion in economic output, and contributed 4.9 per cent to gross value added (table 2.1). The greatest contribution to value added and hours worked was from other store based retailing, which includes a wide range of retail categories such as furniture, electronics, and department stores (box 1.1).

Table 2.1 The contribution of Australian retail trade, 2012-13

		<i>Motor vehicle and motor vehicle parts retailing</i>	<i>Fuel retailing</i>	<i>Food retailing</i>	<i>Other store based retailing</i>	<i>Non store and comm-based buying and/or selling</i>	<i>Total retail industry</i>	<i>Retail industry as a proportion of all industries<sup>a</sup></i>
Total employment	no.	102 925	41 120	416 557	685 883	25 473	1 271 957	10.6
Number of businesses <sup>b</sup>	no.	10 072	3 891	24 734	81 392	13 289	133 375	6.4
Wages and salaries <sup>c</sup>	\$m	5 507	1 243	11 876	21 013	796	40 435	6.2
Net capital stock	\$m	na	na	na	na	na	64 738	1.4
Gross fixed capital formation	\$m	na	na	na	na	na	6 167	1.4
Industry value added	\$m	9 575	2 863	22 035	33 554	1 628	69 655	4.9

<sup>a</sup> Retail employment as a proportion of total is estimated using ABS Labour Force data. Wages and salaries proportion of total and retail industry value added as a proportion of total have been estimated using data from the Australian System of National Accounts. <sup>b</sup> Numbers may not add due to rounding. <sup>c</sup> Includes capitalised wages and salaries; excludes drawings of working proprietors. **na** denotes not available.

Sources: Commission estimates based on ABS data (Cat. no. 5204.0, 2013; Cat. no. 8622.0, 2014; Cat. no. 6291.0.55.003, 2014; Cat. no. 8165.0, 2014).

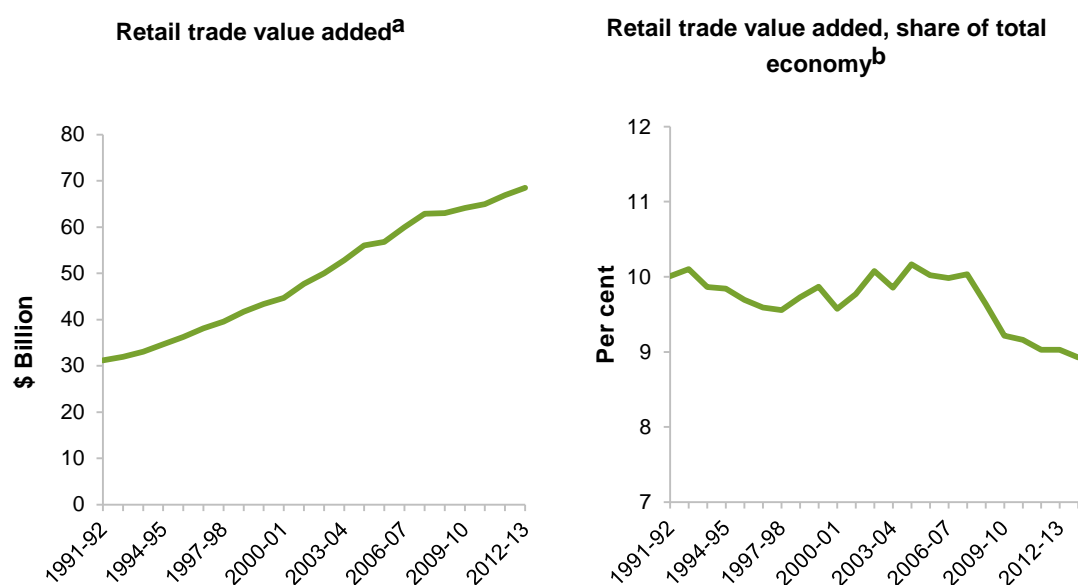


In 2012-13, there were 133 375 retail businesses in Australia. In 2013-14, around 1.8 billion hours were worked in the industry, accounting for some 8.9 per cent of total hours worked in Australia (ABS 2014g).

The relative contribution of the industry to the overall economy has been declining slightly over the past decade, notwithstanding a small upturn in 2012-13 (figure 2.2). A similar trend is evident in the number of hours worked. While the number of hours worked in retail increased overall between 1991-92 and 2013-14 (despite a decline following the global financial crisis), the retail industry's share of total hours worked has declined by around one percentage point since 2007-08 (figure 2.3).

The slight decline in the relative importance of retail trade is due to a number of factors. In part, it reflects the changing structure of the Australian economy — with relatively higher growth in other parts of the economy, notably in services and the mining sector (Connolly and Lewis 2010; PC 2012a). It is also a result of changing consumer preferences (section 2.4).

**Figure 2.2 Contribution of the retail sector to gross value added**



**a** Chain volume measure of gross value added at basic prices. A basic price is the amount receivable by the producer from the purchaser for a unit of a good or service produced as output minus any tax payable, and plus any subsidy receivable on that unit as a consequence of its production or sale. **b** Percentage of gross value added in current prices.

Source: ABS (Cat. no. 5204.0, 2013).

**Figure 2.3 Contribution of the retail sector to total hours worked**



<sup>a</sup> Hours worked estimates for retail trade and all industries in June 2000 quarter are not available due to questionnaire changes. The June 2000 quarter was imputed as the average of the three other quarters in 1999-00. <sup>b</sup> Share of total hours worked across all industries.

Source: Commission estimates from ABS data (Cat. no. 6291.0.55.003, table 11, 2014).

## 2.3 Performance of the retail industry

### The performance of retail businesses is mixed

There has been a slowdown in total retail sales growth since 2008-09. From 2008-09 to 2013-14, average growth in retail trade turnover was about 2.4 per cent per year. This compares with an average growth rate of about 3.4 per cent per year from 2003-04 to 2008-09. Net retail margins — or profits — have remained relatively stable for the whole industry over the past two decades (chapter 3).

Performance across retail subsectors is mixed (table 2.2). For example, in 2012-13 retail profit margins averaged 4.9 per cent, while the average profit margin for food retailing was 6.3 per cent and the average profit margin for other store-based retailing (which includes clothing and footwear, household furnishings and other goods of a more discretionary nature) was 4.8 per cent.

**Table 2.2 Performance indicators for the retail industry 2012-13**

Selected retail subsectors and total retail industry

		<i>Motor vehicle and motor vehicle parts retailing</i>	<i>Fuel retailing</i>	<i>Food retailing</i>	<i>Other store-based retailing</i>	<i>Non store and comm- based buying and/or selling</i>	<i>Total retail industry</i>
Operating profit before tax	\$m	2 586.4 <sup>a</sup>	1 177.7	6 973.3	7 010.0	534.5 <sup>a</sup>	18 282.0
Average profit per business <sup>b</sup>	\$'000	256.8	302.7	281.9	86.1	40.2	137.1
Profit margin <sup>c</sup>	%	3.5 <sup>a</sup>	3.0	6.3	4.8	7.9 <sup>a</sup>	4.9
Industry value added per person employed	\$'000	93.0	69.6	52.9	48.9	63.9	54.8
Businesses that made a loss	%	19.8	29.9	23.2	28.2	29.1	26.8

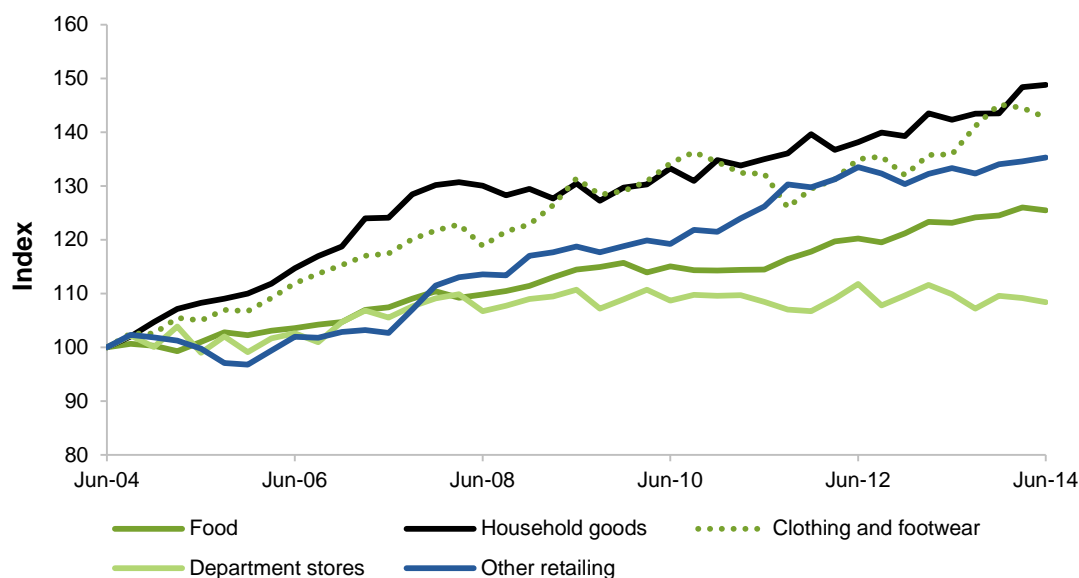
<sup>a</sup> Estimate has a relative standard error of 10–25 per cent and therefore should be used with caution.<sup>b</sup> Average profit per business is estimated as operating profit before tax divided by the number of businesses in each subsector as at June 2013. <sup>c</sup> Profit margin is the percentage of sales and service income available as operating profit before tax.*Sources:* Commission estimates based on ABS data (Cat. no. 8165.0, 2014; Cat. no. 8622.0, 2014; Cat. no. 8155.0, 2014).

Variability is also evident in long term trends of retail turnover, with growth in turnover stronger in some subsectors compared to others. For example, over the past decade, growth in retail turnover in the household goods and the clothing and footwear subsectors has outpaced growth in department store retail turnover (figure 2.4).

Sales at department stores have been particularly affected by the economic environment, low consumer confidence and heightened competition from specialty retailers and online retailers such as Amazon (IBISWorld 2014). The share of department store turnover as a proportion of total retail turnover has fallen from 10.2 per cent in 2003-04 to 7.7 per cent in 2013-14 (Commission estimate based on ABS 2014i).

Retail sales in certain subsectors also tend to be relatively more volatile. In particular, household spending on durable goods — clothing and footwear, furnishings and household goods and vehicles — can be influenced more by the business cycle and economic climate than spending on non-durable goods (such as food). Indeed, following the global financial crisis, consumer spending on durable goods in Australia fell by 6 per cent, driven by a decline in confidence levels, tighter trading conditions, and greater caution around spending and investment decisions (Black and Cusbert 2010).

**Figure 2.4 Quarterly growth in retail turnover<sup>a</sup>**  
Indexed June 2004 quarter = 100



<sup>a</sup> Chain volume measure of seasonally adjusted retail trade turnover.

Source: Commission estimates based on ABS data (Cat. no. 8501.0, 2014).

#### FINDING 2.1

Largely reflecting the economic climate, growth in retail turnover has been slow over the past five years compared to the five years prior. Performance has been mixed across the sector with growth in turnover particularly weak for department stores.

## Productivity growth has been relatively strong

Productivity measures how efficiently primary factor inputs, such as capital and labour, are used to produce outputs in the economy. Productivity growth indicates businesses have reduced their primary factor input use relative to their output. While growth in productivity can provide an indication of the efficiency with which the retail industry has been able to convert its inputs into output, it does not necessarily provide an indication of consumer welfare.<sup>1</sup>

<sup>1</sup> For example, replacing labour with self-service checkouts (without any fall in sales) could result in an improvement in multifactor productivity, though it could also be seen as a shift in work from sales staff to the consumer.

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## Retail labour productivity growth has been relatively strong

Labour productivity measures efficiency in the use of labour, and also captures the growth in the capital intensity of production processes. Labour productivity growth in retail trade from 1993-94 to 2012-13 has been comparable to that of the 12 industry market sector<sup>2</sup> (2.5 per cent per year in retail compared to 2.4 per cent per year in the 12 industry market sector) (table 2.3). More recently, labour productivity growth in the retail industry has been considerably stronger than growth in the 12 industry market sector at 2.7 per cent per year compared to 1.9 per cent per year.

## Retail multifactor productivity growth has also been relatively strong

Multifactor productivity (MFP) measures the efficiency of producers in generating output using both labour and capital (this measure comes closest to the underlying concept of productivity). It reflects improvements in efficiency in the use of labour and capital, and is commonly referred to as a measure of technological change. In the retail trade sector, innovations such as scanning technology and computerisation are likely sources of MFP growth. MFP growth in the retail sector has averaged 1.6 per cent per year since 1993-94 (table 2.3).

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**Table 2.3      Productivity growth in retail trade and the 12 industry market sector<sup>a</sup>**

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

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

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

Source: Commission estimates based on ABS data (Cat. no. 5260.0.55.002, 2013).

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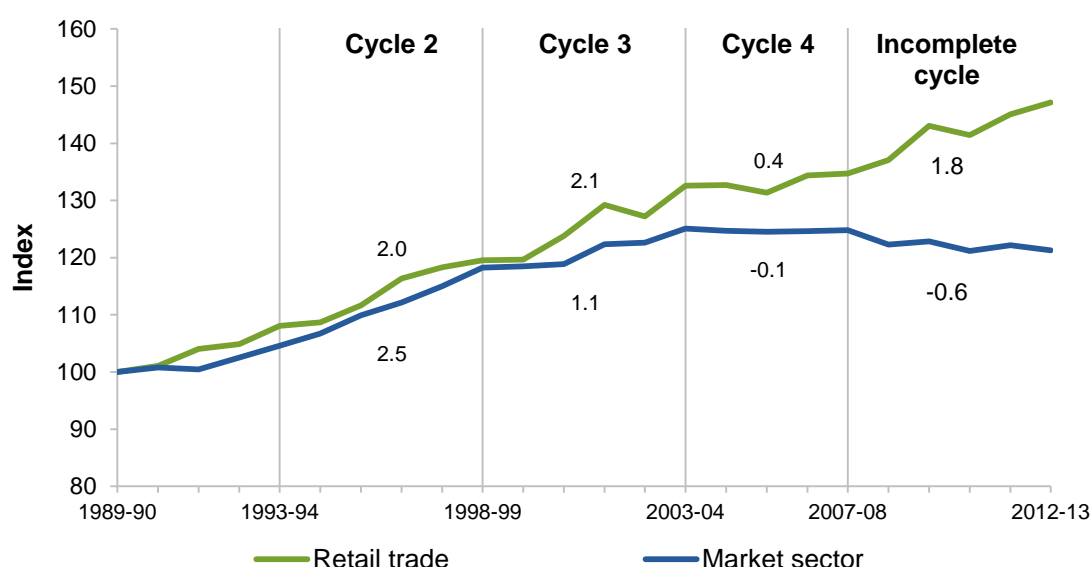
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<sup>2</sup> The 12 industry market sector comprises: Agriculture, forestry and fishing; Mining; Manufacturing; Electricity, gas, water and waste services; Construction; Wholesale trade; Retail trade; Accommodation and food services; Transport, postal and warehousing; Information, media and telecommunications; Financial and insurance services; and Arts and recreation services.

Retail trade MFP growth has been higher than the 12 industry market sector for most periods since 1993-94 (figure 2.5) and has, on average, been double the growth rate of the market sector as a whole over this period. Retail MFP growth has been particularly strong compared to market sector MFP growth over the past 10 years. However, Australia's market sector MFP growth over this period has been poor when compared with long term MFP growth of 0.7 per cent per year from 1973-74 to 2012-13. It has also been poor over the past decade when compared to MFP growth in other countries over the same period (PC 2014b).

**Figure 2.5 MFP growth in retail trade has been faster than the 12 industry market sector**

By cycle and indexed at 1989-90 = 100



Source: Commission estimates based on ABS data (Cat. no. 5260.0.55.002, 2013).

Capital deepening in retail trade (an increase in the capital-labour ratio weighted by the share of capital) has remained relatively constant over the productivity cycles (table 2.3).

#### FINDING 2.2

Growth in labour productivity and in multifactor productivity (MFP) in the retail sector have been considerably stronger than in the market sector over the past five years. However, Australia's market sector MFP growth has been poor over the past decade when compared with long term MFP growth.

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## 2.4 The industry is evolving

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

Economic, social, demographic and technological factors are changing what consumers buy, where and when they buy and how much they are willing to pay.

### Changes in consumer behaviour and tastes

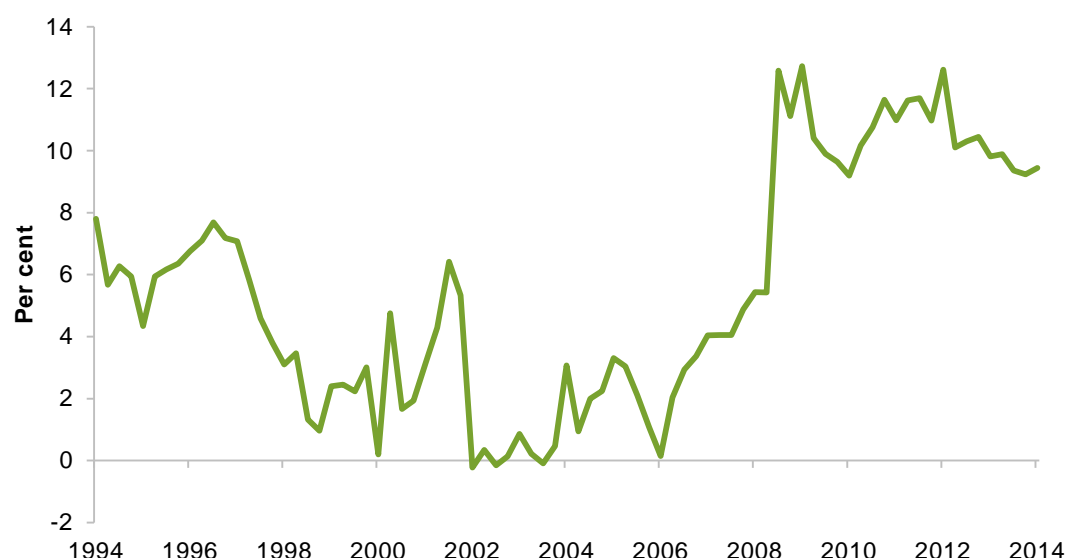
The trend in the household saving ratio in Australia (figure 2.6) since the global financial crisis indicates that even with growing incomes, households have been unwilling to increase their rate of consumption:

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

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Figure 2.6 **Households are saving more than prior to the GFC**

Household saving ratio<sup>a</sup>, June 1994 to June 2014



<sup>a</sup> The household saving ratio is the ratio of net saving to net disposable income. Household net saving is net disposable income less final consumption expenditure. Household net disposable income is gross disposable income less consumption of fixed capital. Estimates are based on seasonally adjusted data in current prices.

Source: Commission estimates based on ABS data (Cat. no. 5206.0, 2014).

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Households are also spending a smaller share of their consumption expenditure<sup>3</sup> on retail goods, instead purchasing more services provided by other industries (Beech et al. 2014). They are also becoming more price conscious and are seeking greater value for money (Woolworths 2014). Changes in demographics, consumer tastes and behaviours are also impacting upon consumer purchases (box 2.1).

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

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

- the workforce participation rate of mothers with a child under 15 years has grown from 57 per cent to 66 per cent over the past two decades (PC 2014a)
- people are living longer and the population aged 75 years or more is expected to continue to rise (PC 2013a)
- in 2001, 47.2 per cent of people aged 15–64 had a non-school qualification, compared to 57.2 per cent in 2013 (ABS 2013a).

There have also been economic changes over this period, including a substantial increase in real incomes (Greenville, Pobke and Rogers 2013). Employment patterns have also shifted — there has been an increase in the proportion of the workforce employed in the services sector and an increase in those working outside of ‘standard’ office hours (PC 2012a).

These changes have shaped consumer preferences. Australian households have substantially increased their expenditure on services relative to goods (Beech et al. 2014). Expenditure on services that were previously produced within the household (such as meals, childcare and home maintenance) has increased.

Household expenditure on food has also changed. Immigration has brought new cuisines to Australia. Higher incomes have enabled consumers to spend more on food — there has been growth in spending on specialty foods and eating out (Woolworths, KPMG and Quantum 2013).

In general, these changes mean that Australian consumers have become more diverse and more demanding, not only with respect to *what* they buy but also *when* and *how* they buy. Technological changes, such as the development of online shopping, have given consumers greater scope to shop according to their preferences. Australian consumers are indeed avid online shoppers — making Australia one of the most attractive cross-border e-commerce markets for retailers (Borderfree 2013).

## **Technological change**

Technological advancements have been significant drivers of change and have expanded the retail market for Australian consumers. As noted by the National Retail Association:

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



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... over the past decade, the retail sector has been undergoing a significant structural upheaval, following advancements in technology, digitalisation and online shopping. These changes have led to new consumer behaviours, new retailing models and increased competition through effective globalisation of retail markets. The structural shifts have brought about significant changes in the retail sector in a short period of time, with both challenges and opportunities for retailers. (sub. 18, p. 3)

E-commerce allows consumers to access a greater range of products, often at lower prices, and at a time and in a manner that suits their preferences. The internet has enhanced consumers' ability to research and compare a broad range of products prior to making a purchase, and has diminished the geographic barriers associated with retail trade (box 2.2). The Swimming Pool and Spa Alliance commented:

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

### **Box 2.2      The way Australian consumers shop has been changing**

Shopping habits are changing in a number of ways.

- Shopping on a Sunday has grown in popularity while Saturday shopping is becoming less popular.
- Consumers are able to shop online at all hours of the day. While the majority (80 per cent) of online retail transactions occur between the hours of 9 am and 11 pm, the most popular online shopping hours are 8 pm to 10 pm.
- Consumers are doing most of their shopping outside of their suburb, and increasingly online.
- Consumers are able to seek advice and information on retail products through an increasing array of channels, including international product forums and overseas retailers.

To illustrate the way consumers shop, Woolworths provided an example of the Chatswood precinct in Sydney in its submission to the Australian Government competition policy review. There are a number of major shopping centres in the precinct, including the large Chatswood Chase. Data indicate that consumers in the area spend around \$9 billion per year on retail. Of this, \$800 million is spent online (around 9 per cent), with \$600 million at domestic online retailers and \$200 million at overseas online retailers.

*Source: Woolworths (2014).*

E-commerce is a significant enabler of competition. It can reduce barriers to market entry due to the relatively low start-up costs for new market entrants (Google 2014).

E-commerce has also enhanced contestability in the market as the Australian retail sector has become increasingly exposed to international trade (box 2.3). However, there are several factors that limit the scope for international trade in retail goods. Some factors,

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such as exchange rates and shipping charges, influence the relative price of goods overseas compared to domestic purchases, while other factors, such as limited shelf-life, are driven by the nature of the product. Restrictions imposed by governments and retailers can also limit the scope for international trade in retail goods. For example, some retailers have adopted ‘geoblocking’, in which restrictions are placed on the sale of products or prices are adjusted depending on the geographic location of the buyer.

**Box 2.3      Participants’ comments on the increasing contestability of Australian retailing**

Like any Australian retailer, Bunnings competes with international retailers, including Amazon, which requires us to be constantly vigilant to international pricing. (Bunnings, pers. comm., May 2014)

There is increasing pressure for Australian Large Format retailers to be cost competitive against overseas and online based competition. (Large Format Retail Association, sub. 19, p. 6)

... while many Australian retailers have started their own online stores ... the fact remains that Australians are continuing to shop at overseas online stores in ever increasing numbers, drawn there in part because those overseas competitors continue to have an unfair price advantage over Australian retailers ... (Australian Sporting Goods Association, sub. 10, p. 4)

Small and medium bricks and mortar retailers are finding it impossible to compete purely on price with overseas online retailers. ... Many small businesses in the retail industry pointed to overseas competition via online purchasing as ‘killing profitability’, and thus directly affecting the ongoing viability of many businesses in retail. ... competition with overseas retailers selling at lower prices, skills shortages in digital technology in retail, the growth of non-store channels, and general hesitancy of bricks and mortar stores to take up digital sales techniques has exacerbated ... challenges. (Chamber of Commerce and Industry Queensland, sub. DR29, p. 7)

Like the traditional retail sector, online retailing is a continually changing landscape. New ways of retailing have developed online, which have provided greater choice for consumers. Online sales formats include auction houses, market places and the more traditional specialty or brand-based online retail stores.

Many online retailers have also established platforms to sell products over mobile phones and hand-held devices (m-commerce). Retailing through mobile devices can provide different opportunities to more traditional online retailing — for example, retailers may be able to take advantage of location-based mobile marketing, such as ‘geofencing’. Geofencing allows companies to target specific customers by setting up a virtual boundary. When the customer steps within that boundary they receive relevant retail offers or notifications (AWPA and SSA 2014).

The Chamber of Commerce and Industry Queensland commented:

Technological innovation has presented the small business retail sector with both opportunities and challenges. The use of smart devices has assisted with client enticement and loyalty via social media applications and provided for virtual shopping alternatives. (sub. DR29, p. 7)

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Further, many Australian retailers are adopting a multi-channel approach to sales, utilising bricks and mortar stores and digital sales platforms, such as online and mobile channels, to engage consumers (bricks and clicks). As noted by the Shopping Centre Council of Australia:

Bricks and mortar stores can play an important role in e-commerce whereby an item or service is ordered online and then ‘fulfilled’ (e.g. delivered or picked up) from the store. ... shopping centres have investigated and adopted e-commerce solutions to better facilitate the retail economy. Examples of our members’ support for e-commerce include the following:

- online portals to search, compare and purchase their retailers’ goods.
- free Wi-Fi within their shopping centres to facilitate e-commerce.
- teaming up with Google to map the internal layouts of shopping centres to assist shoppers in navigating a centre. ...
- websites, apps and social media that provide centre and store information and relevant promotions. ... (sub. DR27, p. 4)

Online shopping represents a relatively small but growing proportion of overall retail trade

Collection of online sales data is still developing. In 2011, the Commission recommended that the ABS monitor and report online expenditure both domestically *and* overseas. Since March 2013 the ABS has produced experimental estimates of the value of turnover from domestic online retail sales, disaggregated between multi-channel and pure-play online retail trade activity. These data do not account for purchases from overseas retailers and non-employing businesses (such as micro businesses on eBay).

Several other organisations compile data on online retail trade using information from credit and debit card transactions (table 2.4). Unlike the ABS data, which are compiled from industry surveys, transaction-based data are more likely to reflect consumption. The transaction-based estimates suggest that online shopping accounts for around 6 per cent of total retail sales (Commonwealth Bank 2014; NAB 2014c). Currently around 25 per cent of Australian consumers’ online purchases are from international retailers (NAB 2014a).

Based on the available estimates, Australia’s online sales as a proportion of total sales (at around 6 per cent) remain slightly lower than online sales in the United States (around 8 per cent) and United Kingdom (around 13 per cent), but similar to other countries such as Germany (around 7 per cent), New Zealand (around 6 per cent) and France (around 5 per cent) (chapter four) (Bachl and Koll 2013; PwC 2012).

**Table 2.4 Estimates of online shopping**  
Per cent of total retail trade

<i>Source</i>	<i>Time period</i>	<i>Estimate</i>
Australian Bureau of Statistics <sup>a</sup>	12 months to end July 2014	2.8
National Australia Bank <sup>b</sup>	12 months to end July 2014	6.6
Commonwealth Bank <sup>c</sup>	12 months to end January 2014	5.5

<sup>a</sup> The ABS uses data collected through its retail trade survey. This excludes data from overseas purchases as well as non-employing businesses, and restricts data collection to those businesses within the defined set of ANZSIC classifications. Motor vehicles, motor vehicle parts and fuel are excluded. <sup>b</sup> The NAB data are drawn from transaction data and include overseas purchases, as well as purchases of online music and eBook downloads. <sup>c</sup> Commonwealth Bank data are from credit and debit transactions, and include both pure play and omni-channel online activity.

Sources: Commonwealth Bank (2014); NAB (2014b); Commission estimate using ABS data (Cat. no. 8501.0, 2014).

NAB data indicate that retail sales through online platforms have grown strongly over the past four years. In particular, growth in online sales was significantly stronger than growth in traditional retail sales between 2010 and 2012, when online growth rates were around 20–30 per cent per year (NAB 2014a).

### Australians are enthusiastic online shoppers

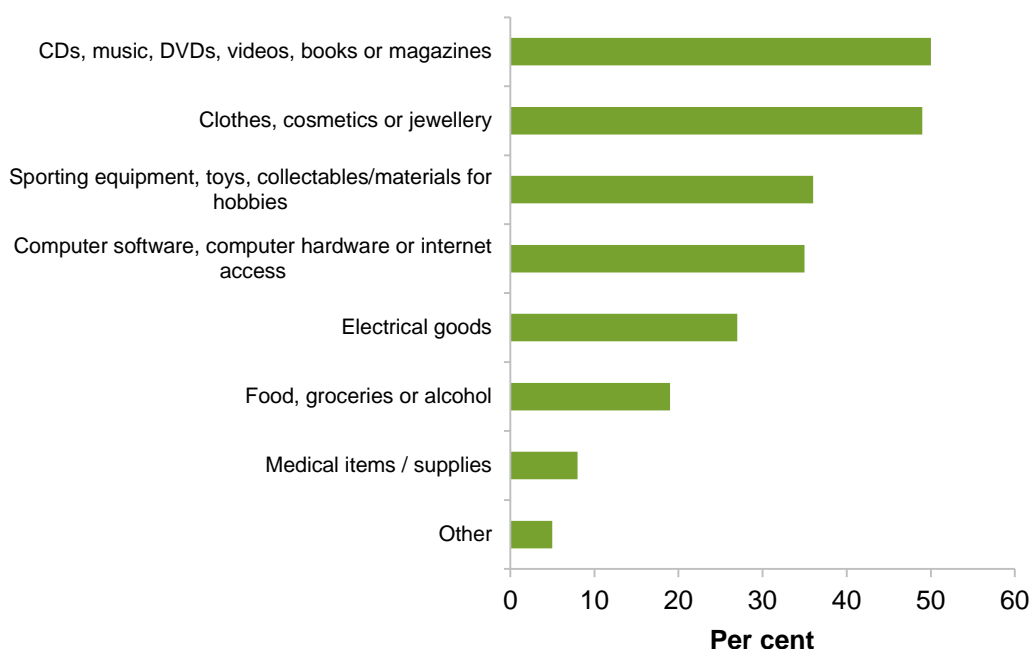
Australian consumers are enthusiastic online shoppers (Borderfree 2013; PwC 2012). A study by Riemer et al. (2014) estimates that, where possible, more than 50 per cent of Australians prefer to buy online. Online retailing is shifting from being a special undertaking to part of everyday shopping for consumers (Ewing 2014). Value, convenience and access to a wider range of goods are the main reasons for consumers shopping online (Morgan Stanley 2013; PC 2011a).

Of Australian internet users (83 per cent of persons 15 years and over), around 76 per cent used the internet in 2012-13 to purchase or order goods or services (ABS 2014f). Of those who shop online, around 30 per cent make online purchases on a weekly basis (Ewing 2014). The highest proportion of consumers shop online for CDs, music, DVDs, videos, books and magazines, followed by clothes, cosmetics and jewellery (figure 2.7).

Consumers are increasingly using mobile phones or tablet devices to shop online. For example, in December 2013, 3.4 million Australians used their mobile phone to buy goods and services online or undertake banking or bill payments compared to 620 000 in December 2010 (ACMA 2014).

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**Figure 2.7 Proportion of internet users who purchased or ordered goods or services via the internet, 2012-13**



Source: ABS (Cat. no. 8146.0, 2014).

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### Retailers are utilising online platforms, though not to their full potential

For some subsectors of retail trade in Australia, e-commerce has become an important avenue for sales. ABS data suggest that around 15 per cent of entertainment media retail sales and 7.4 per cent of clothing retail sales occurred online in 2012-13. In comparison, only around 1.3 per cent<sup>4</sup> of food retailing sales occurred online. Further, it is estimated that only 0.8 per cent of Australian department store sales occurred online in 2012-13 (ABS 2014h). This is partly due to the strong competition Australian department stores face from international department and specialty stores online, and could also reflect that department stores have been slow to fully embrace online retailing (IBISWorld 2014; PC 2011a).

Similarly, the proportion of retail businesses receiving orders over the internet — around 38 per cent — has also grown (figure 2.8). The proportion of small and medium sized retail businesses, receiving orders online remains lower, at 18 per cent (Sensis 2013).

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<sup>4</sup> The ABS estimate for online sales of food has a relative standard error of 10–25 per cent and therefore this figure should be used with caution.

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**Figure 2.8    The proportion of businesses that receive orders via the internet is growing**



Source: ABS (Cat. no. 8166.0, 2014).

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However, a recent report has found that 38 per cent of Australian retailers assessed could be considered ‘digital commerce laggards’ (Riemer et al. 2014, p. 16). The study found that while Australian retailers’ online presence provides for basic online purchasing and product information (referred to as ‘execution’), Australian retailers are generally lagging behind international industry market leaders in effective online engagement with customers through social media, forums and retailers’ own digital spaces (figure 2.9). The report warns that given increased competition from overseas, Australian retailers face a high risk of losing customers should they not build stronger relationships and harness consumer loyalty (Riemer et al. 2014).

**Figure 2.9 Australia's relative performance in online retailing**  
Australian industry average and international industry market leaders



<sup>a</sup> Digital execution refers to the provision of information and the facilitation of purchase transactions online. <sup>b</sup> Digital engagement comprises relational and social interaction with customers across social media, forums and a retailer's own digital spaces.

Source: Adapted from Riemer et al. (2014).

#### FINDING 2.3

E-commerce is creating an increasingly global retail market, broadening the geographic footprint of competing retailers and giving more choice to consumers. Online retailing accounts for a small but growing proportion of total retail trade (around 6 per cent). For certain subsectors, online sales represent a significant share of total sales (for example, entertainment media and clothing). However, for other subsectors (such as food), online retailing is a relatively small proportion of total sales.

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## **Retail businesses are responding to competitive pressures**

Many retailers are adapting their businesses in order to compete for market share. In many cases, these strategies are designed to offset the increasing tradability created by e-commerce and capture the opportunities that technological change has created.

Retailers are striving for non-price points of difference based on a combination of personalised service, quality of goods, convenience and range. For example, supermarkets are moving into new segments — offering sushi bars, barista coffee, cafes with Wi-Fi and a larger range of take-away and convenience foods. The convenience of online grocery shopping is also expected to increase with the development of more flexible and efficient formats, such as ‘dark warehouses’ dedicated to online sales. According to the Australian Newsagents’ Federation:

Newsagents are diversifying into new markets such as parcel delivery and other e-commerce services. They are developing broader retailing capacity and are expanding their competitive offering to take back ground from competitors who compete for traditional newsagency customers. (2014, p. 2)

In some cases, retailers are seeking to combine their bricks and mortar presence with new technological developments. For example, David Jones has launched ‘village format’ stores, which occupy a smaller retail space and provide customers with features such as digital charging stations, complimentary Wi-Fi, an interactive tweet mirror and dedicated areas to purchase and collect products from the David Jones online store (PwC 2013).

Similarly, online retailers are also creating a more life-like shopping experience for consumers. For example, some online retailers have introduced virtual changing rooms, or offer free shipping and/or truncated delivery times on purchases. The Commission visited one online retailer that has introduced a ‘showroom’ bricks and mortar store within a traditional department store where consumers are able to experience the product that they can purchase online. Another online retailer has opened a ‘collection bar’ where customers are able to try on and collect their purchases.

To predict shopper behaviour and offer more personalised shopping experiences, many retailers are drawing on consumer data from in-store sales, online behaviour and social media (KPMG 2013).

Retail businesses are also innovating and adopting a range of strategies to reduce their cost of doing business. These are further discussed in chapter 3.



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## 3 Retail cost structures

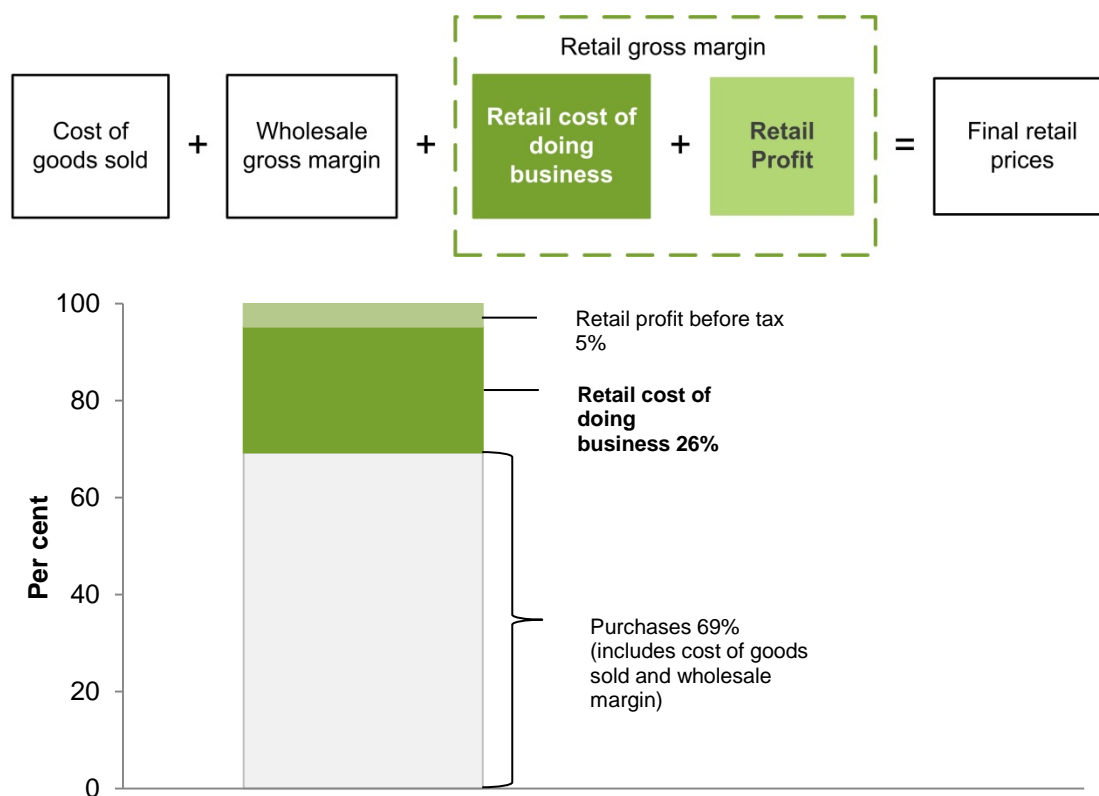
### Key points

- The main costs of doing business in retail trade are labour and occupancy costs. Cost structures vary across types of retail trade and between individual businesses — freight, electricity and warehousing are also major costs for some areas of retail.
- Overall, the retail cost of doing business accounts for around a quarter of retail prices, with the remainder attributable to the wholesaler's margin, the cost of goods themselves and the retailer's profit margin.
- Retailers have experienced significant increases in input prices in recent years, with several major input prices — including wages — increasing roughly in line with the consumer price index but by more than final retail prices. Despite the increases in input prices:
  - in aggregate, profit margins have been relatively stable over the past two decades. To some extent, overall profitability has been protected by falls in the cost of imported goods sold.
  - for the retail trade sector as a whole, labour costs appear relatively stable as a share of the cost of doing business over the past 15 years.
- The aggregate picture of stability obscures the diversity and dynamism of the industry. Recent years have been a period of evolution, innovation and churn.
  - The industry is leaner. While employment has grown over the past 15 years, it slowed significantly after 2007-08. The number of persons employed is still lower than pre-GFC levels. Labour productivity has also increased faster than the market sector during this period. To some extent, this has counteracted the increases in retail wages.
  - New business models, including 'large format' and online retailing, have brought new cost structures to retail trade.
  - The diversity of the industry has meant that retailers differ markedly in their experiences of cost drivers and their ability to respond.
- Some retailers compete with relatively high costs — for example, paying higher wages in order to compete on quality of customer service.
- The retail industry is responding to rising input prices through various strategies to reduce costs and/or increase competitiveness. Some of these strategies are better suited to larger retailers — particularly those involving large capital outlays. Other strategies, such as moving to online retailing, are open to retailers of all sizes to varying degrees.

### 3.1 Retail cost structures

The consumer prices of retail goods can be broken down into the price paid by wholesalers to manufacturers; the price paid by retailers to wholesalers (or, in some cases, directly to manufacturers); and the remainder being retained by the retail trade sector (figure 3.1). In other words, the revenue received by retailers includes income to both the manufacturing, and wholesaling industries, with the remaining income retained by the retail trade sector. This retail income is comprised of the retail profit margin and the cost of doing business — the latter being the focus of this study.

Figure 3.1 Breakdown of retail revenue, 2012–13<sup>a</sup>



Source: ABS (Cat no. 8622.0, 2014).

Final retail prices and, to some degree, retail profitability, are affected by both the prices charged by manufacturers and any margins earned by wholesalers. Exchange rates also play an important role in the ‘cost of goods sold’, given that around 40 per cent of retail goods are imported (D’Arcy, Norman and Shan 2012). The Commission’s study does not directly analyse the cost of goods sold, nor the wholesale margin.

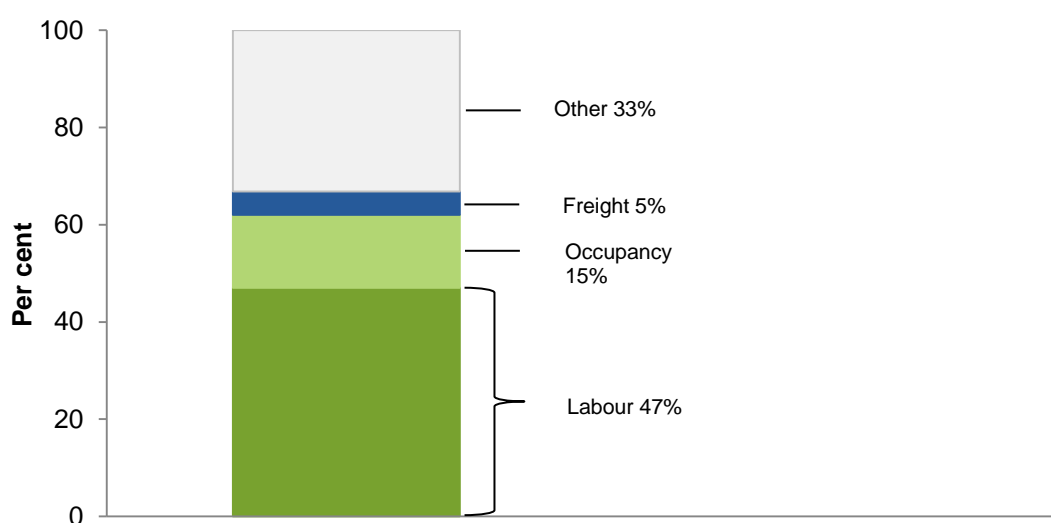
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## Retail cost of doing business

The main costs of doing business for the retail sector are labour and occupancy costs, and to a lesser extent, freight (figure 3.2). Other costs of doing business include utilities, professional and financial services, as well as warehousing and distribution. The main areas of capital investment for retail businesses are in machinery and equipment, as well as non-dwelling construction.<sup>5</sup>

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Figure 3.2    **Breakdown of retail cost of doing business, 2012–13<sup>a</sup>**



<sup>a</sup> Occupancy includes rent and leasing expenses related to land, buildings and other structures. 'Other' relates only to costs of doing business and so do not include the 'cost of goods sold'.

Source: ABS (Cat no. 8622.0, 2014).

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Another way to measure the labour-intensive nature of retail trade is through a direct comparison of the factor incomes to capital and labour, where again, retail trade tends to be relatively labour intensive. According to ABS National Accounts data, factor income in retail trade was split between 32 per cent capital and 68 per cent labour, compared to the average for all industries being 46 per cent capital and 54 per cent labour.<sup>6</sup>

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<sup>5</sup> According to ABS National Accounts, in 2012–13, gross capital formation in the retail trade sector consisted of machinery and equipment (56 per cent); non-dwelling construction (29 per cent); computer software (13 per cent); and research and development (2 per cent).

<sup>6</sup> ABS (*Australian System of National Accounts*, Cat. no. 5204.0, table 46).

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## Diversity in retail cost structures

Publicly listed retail companies regularly publish details of their cost structures. While these companies must provide financial statements in accordance with accounting standards, such standards do not prescribe a format of cost breakdowns at the level of detail that would be of most interest to this study. As a result, the cost structures found in annual reports are only partially comparable.

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

### Cost structures reflect business models and types of retailing

The available evidence suggests that cost structures vary across types of retail trade and between individual retailers (figures 3.3 and 3.4).<sup>7</sup> In most types of retail, labour and occupancy costs comprise at least half of the costs of doing business. These findings are consistent with unpublished data from IBISWorld.

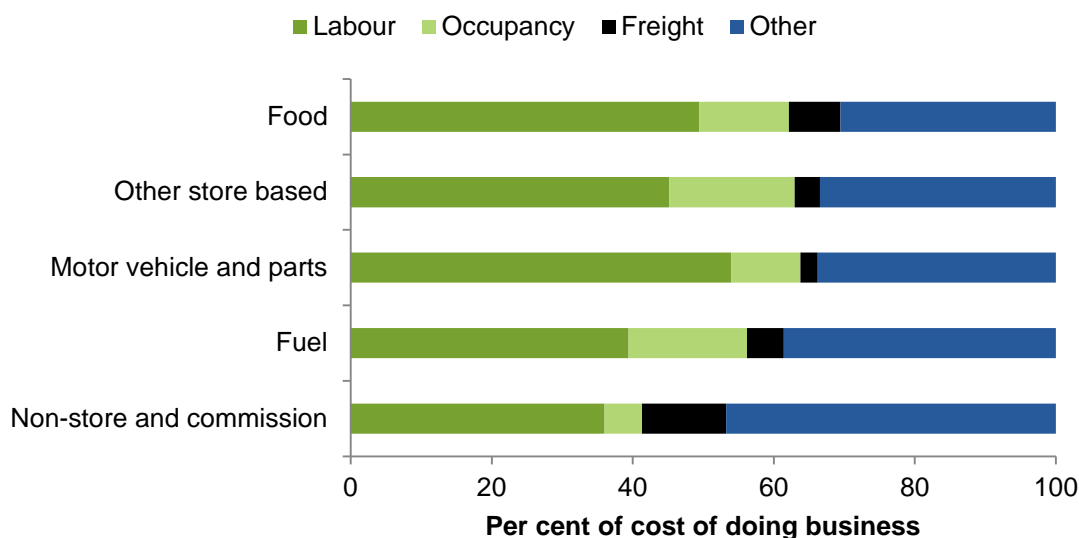
Aside from labour and occupancy, other significant areas of cost include freight, marketing and utilities. However, the importance of these costs differs across different types of retail, and between competitors. To illustrate, IBISWorld data suggest that around one fifth of supermarkets' cost of doing business related to advertising, while for florists, around one quarter of the cost related to marketing and distribution. Energy costs are also significant for liquor retailing, at around 9 per cent.

The different cost structures are likely to reflect differences in the business models that are appropriate for various types of retail. For instance, some retailers require refrigeration for their products, necessitating greater energy expense. For some products, price is a more important competitive factor than any aspects of quality or customer service — in such circumstances, retailers can be expected to spend less on store fittings and service. In other cases, the quality of customer service may give the retailer a competitive edge, and retailers may compete for higher quality staff by paying higher wages. Essentially, cost structures are determined by a myriad of factors and business decisions.

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<sup>7</sup> Retail businesses are not always as neatly delineated into subdivisions as described in figure 3.3, or in ANZSIC classifications. For example, it is not unusual for a shop that sells Hardware and Building Supplies to also sell Garden Supplies, Floor Coverings, or Domestic Appliances. Product mixes have changed over time, reflecting evolving business models (and hence, changing cost structures).

**Figure 3.3 The relative shares of the costs of doing business differ across types of retail 2012–13<sup>a</sup>**



<sup>a</sup> 'Other' relates only to costs of doing business and so do not include the 'cost of goods sold'.

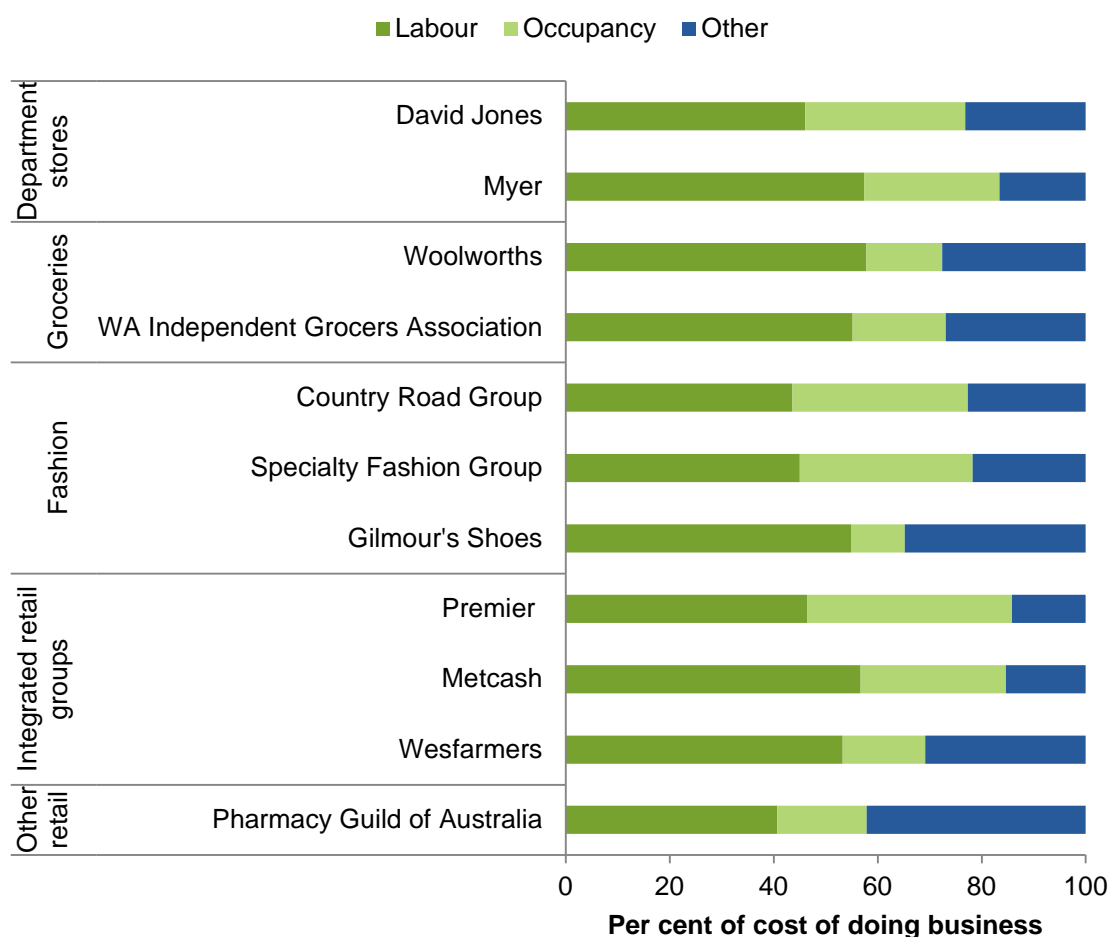
Source: ABS (Cat no. 8622.0, 2014).

The cost structures observed in individual businesses often reflect complex organisational structures. Many larger businesses have portfolios spanning different types of retail trade — for instance, Wesfarmers and Woolworths are involved in supermarkets, food outlets, hardware and fuel retailing. Retail businesses are often part of vertically integrated companies, which may own retail, wholesale and manufacturing businesses. For such companies, the presence of cost synergies, supply chain efficiencies, and bargaining power are likely to have an effect on cost levels and structures.

Cost structures would not in themselves indicate whether a business model is good or bad, nor would it imply the need for policy intervention. They can only give some indication of the scale of regulatory or policy impacts on business costs. Reform should focus on factors that cannot be controlled by retail businesses (such as compliance costs or input prices), and particularly with regard to barriers and burdens resulting from inefficient regulation or from market failures.<sup>8</sup>

<sup>8</sup> The term market failure refers to situations where market mechanisms fail to deliver an efficient outcome. Inefficient outcomes can include poor allocation of resources; overproduction of negative externalities; or the underproduction of positive externalities. Market failure does not refer to the failure of individual businesses.

**Figure 3.4 The relative shares of the costs of doing business differ across retailers 2012–13<sup>a</sup>**



<sup>a</sup> WA Independent Grocers Association (WAIGA) provided a range of percentages covering their diverse membership. The figure presents the median of those percentages. 'Integrated retail groups' are comprised of a diverse set of retail businesses, and may also own wholesale businesses, though the term is only indicative — large companies such as Woolworths are also diverse and could be classified as such. 'Other' expenses do not include cost of goods sold, changes in inventory of finished goods or foreign exchange losses.

Sources: WA Independent Grocers Association, sub. 2; Gilmour's, sub. 11; Pharmacy Guild of Australia, sub. DR23; various annual reports FY2013.

#### FINDING 3.1

Although there is significant diversity in cost structures across areas of retail trade, labour and occupancy costs tend to be the single largest costs of doing business. Broad shares of retailers' cost of doing business have been relatively stable over time.

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## Cost structures in online retail

Another determining factor of a retailer's cost structure is the extent to which it operates online. Evidence suggests that as a percentage of sales, the total cost of doing business is likely to be lower in online retail (Citi 2011). This is consistent with the views of stakeholders generally (National Retail Association, sub. DR32; pers. comm., 16 April, 17 April; Gilmour's, sub. 11). Yet, Citi suggested this cost advantage was observed for some areas of retail, such as clothing and department stores, and not in other areas such as grocery and electronics retailing.

This is because online retailing lowers some costs of doing business while raising others, which alters the structure of operating costs in ways that are more favourable for some areas of retail. The Commission's stakeholder engagement suggested that, while online retailers save on rent and store staffing costs, there is relatively more emphasis on warehousing and distribution functions (which are labour intensive), as well as marketing (Citi 2011; pers. comm., 21 July 2014). The lack of a visible store front increases the importance of such expenses as marketing — this can involve providing customers with 'personalised digital experiences' in order to cultivate return customers (Riemer et al. 2014). Distribution costs are also more important for online retailers as free shipping and returns are often important factors in gaining market share (Australia Post 2011).

There is relatively little publicly available cost data from pure online retailers. Some evidence from IBISWorld suggests that labour costs are the major cost of doing business for online retailers. Other evidence suggests that online retailers' savings on store rent and staffing were at least *partly* offset by higher warehousing and distribution costs. For example, as a percentage of sales, many Australian clothing retailers pay around 20 per cent in occupancy costs, while ASOS<sup>9</sup> pays 1.5 per cent in warehouse rental along with 10 per cent in distribution costs (Citi 2011, p. 10).

## 3.2 Retail cost of doing business over time

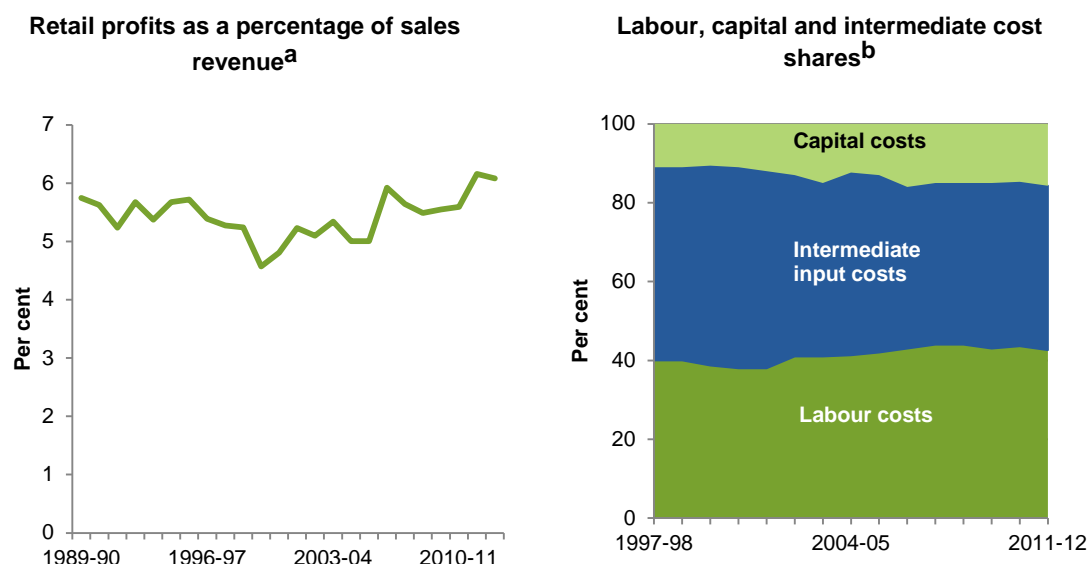
Data from ABS Input-Output Tables show that the retail cost of doing business has held a relatively constant share of retail income between 2004-05 and 2009-10.<sup>10</sup> A comparison between retail profits and retail sales gives an approximation of retail profit margins over time, which also appears to have been relatively stable, notwithstanding some fluctuations (figure 3.5, left panel).

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<sup>9</sup> ASOS is a purely online clothing retailer based in the United Kingdom that operates in the Australian retail market.

<sup>10</sup> This comparison relates to data from input-output tables, from 2004-05, 2007-08, 2008-09 and 2009-10. Due to changes in definitions, comparisons with previous years would be problematic.

**Figure 3.5 The total profit margin and broad cost shares for retail trade have been relatively stable**



<sup>a</sup> Retail profits are taken from gross operating surplus for the retail industry from ABS input–output tables, which are equivalent to retail operating income less cost of goods sold, operating expenses and net taxes on production and imports, but before income tax, depreciation and amortisation. The ratio of gross operating surplus from ABS input-output tables and retail sales from the Retail Industry Survey only provides an approximation of profit margins. <sup>b</sup> This time series is indicative only, as it is subject to series updates relating to ANZSIC as well as National Accounts methodology.

Sources: Commission estimates based on D’Arcy, Norman and Shan (2012) and ABS (Cat. no. 5204.0, 2013; Cat. no. 5676.0, 2013; Cat. no. 5260.0, 2013).

Relative shares of labour, intermediate input and capital costs for the retail sector as a whole have also been stable, with a marginal increase in the shares of labour and capital relative to intermediate inputs (figure 3.5, right panel).<sup>11</sup> The ratio of factor incomes for labour and capital have also been relatively stable over the past 15 years.<sup>12</sup>

While the aggregate picture shows stable cost shares and profitability, experiences have varied across individual retailers (box 3.1). D’Arcy, Norman and Shan (2012) noted that despite stability in aggregate measures of cost and profitability, there have been significant increases in input prices for retailers (other than for the cost of goods sold).

<sup>11</sup> The cost of doing business is comprised of several areas of expense. In aggregate statistics, these are often broken down into: labour costs — paid to retail workers such as customer service staff, managers, and delivery workers; the costs of physical capital — equipment and other capital used in retail (such as buildings, equipment and communications technology); and intermediate inputs — the costs of materials and services from other sectors (such as leasing costs, utilities, freight and professional services).

<sup>12</sup> Calculated as the ratio of Compensation of Employees to total factor income, from ABS (*Australian System of National Accounts*, Cat. no. 5204.0, table 46). Compensation of Employees had remained between 67-70 per cent of total factor income from June 1997 to June 2013.



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**Box 3.1****Some retailers have noted rising costs and shrinking margins**

The National Retail Association (sub. DR32, p. 3) directly disagreed with the idea that profits in the retail sector had remained relatively stable:

We disagree with the Commission's assertion ... that the retail sector as a whole appears to be managing these cost pressures effectively, and that net margins have been relatively stable over the past two decades.

They went on to note that rising costs had eroded profits and led to business closures:

... a consistent theme in our discussions with the majority of our broad membership is that of the growth in costs outpricing the growth in sales in recent years, with those cost pressures currently still building rather than easing. A common story is one of small businesses, or medium chains of stores (mostly in the discretionary categories of retail) experiencing a trend whereby profitable stores become more marginal, or [a] marginal store unprofitable [over time], as labour and other costs grow faster than sales.

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

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

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

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

D'Arcy, Norman and Shan (2012) identified two factors that may have helped to counteract the increases in the cost of doing business, namely:

- changes in the cost of goods sold, largely due to exchange rates
- efficiencies found by the retail trade sector and changes in how retailers conducted business.

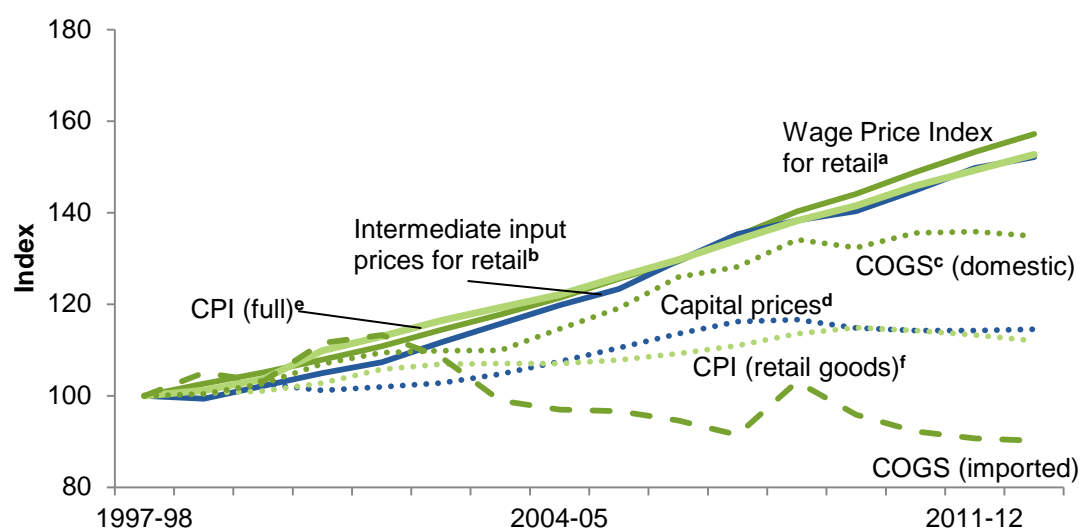
It may also be the case that aggregate statistics do not accurately depict the significant diversity in retail and in intermediate inputs to the sector. That is, industrywide statistics are likely to be skewed towards the larger areas of retail (such as food).

## Input prices over time

Over the past 15 years, prices of labour and intermediate inputs have risen faster than retail prices — as approximated by a modified consumer price index (CPI) that is restricted to retail goods (figure 3.6).<sup>13</sup> This is consistent with the findings of D’Arcy, Norman and Shan (2012), and data from the ABS (2014k) that suggest that prices of inputs such as electricity, non-residential property, and warehousing and storage have risen faster than retail prices over the past decade (figure 3.7).

**Figure 3.6 Labour and intermediate input prices have increased relative to capital prices and final retail prices**

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



<sup>a</sup> The Wage Price Index is calculated based on 'ordinary time hourly rates of pay excluding bonuses', although the series is identical to one calculated based on 'total hourly rates of pay excluding bonuses'. <sup>b</sup> Prices for intermediate inputs, labour and capital are calculated specifically for the retail trade sector. <sup>c</sup> The Cost of Goods Sold (COGS) for both domestic and imported manufactures are based on estimates by D’Arcy, Norman and Shan (2012). <sup>d</sup> Capital prices are calculated as the implicit price deflator for capital stock in the retail sector. <sup>e</sup> The full Consumer Price Index is for all groups as calculated by ABS (2014c). <sup>f</sup> The CPI for retail goods is based on that used by D’Arcy, Norman and Shan (2012), which excludes non-retail goods and services as well as volatile items such as fruit and vegetables and takeaway foods.

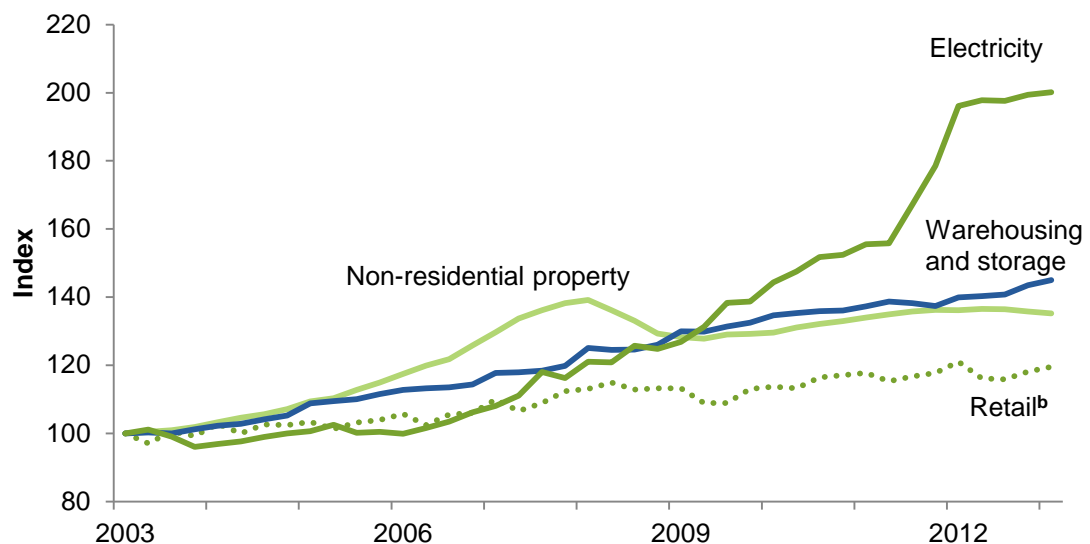
Sources: Commission estimates based on ABS (Cat. no. 5204.0, 2014); D’Arcy, Norman and Shan (2012).

<sup>13</sup> D’Arcy, Norman and Shan (2012) estimated retail prices using a CPI which excluded non-retail goods and services. It included food & non-alcoholic beverages (excluding fruit and vegetables and meals out and takeaway foods), alcoholic beverages, clothing and footwear (less cleaning, repair and hire of clothing and footwear), furnishings, household equipment and services (less domestic and household services), motor vehicles, spare parts and accessories for motor vehicles, audio, visual and computing equipment and services, newspapers, books and stationery, equipment for sports, camping and recreation and games toys and hobbies. Alternative indices include the ABS (2014c) analytical CPI series for 'Market goods excluding volatile items' or for 'Tradables', both of which exhibited much lower growth between 1998 and 2013 than the retail wage price index and the index calculated for retail input prices in figure 3.6.

A comparison of retail input prices with the full CPI, however, tells a different story (figure 3.6). This comparison shows retail wages and intermediate input prices have grown *broadly* in line with overall CPI inflation over the past 15 years, notwithstanding some inputs such as electricity experiencing accelerated price increases (figures 3.6, 3.7). This means that prices for retail labour and intermediate inputs have been roughly in step with the wider economy. Moreover, ABS data indicates that the wage price index (WPI) for retail trade grew by less than the WPI for All Industries between 1997-98 and 2012-13 (ABS 2014j).

**Figure 3.7 Output prices of other industries have grown faster than for retail trade<sup>a</sup>**

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



<sup>a</sup> Electricity prices are proxied by an index of those electricity prices faced by the manufacturing sector. Price indexes are based on the outputs of those industries, and are not limited to the goods and services that are used as inputs in the retail industry. <sup>b</sup> The index for retail prices is the ABS 'Experimental Producer Price Index for the Output of the Retail Trade Industry'.

Source: ABS (Cat. no. 6427.0, 2014).

The difference between trends in the CPI and in final retail prices is due to retail goods only making up around 40 per cent of the CPI basket (RBA 2014). Other items include housing, health, transport, communication, education, recreation and financial services. Prices of retail goods, particularly clothing and footwear, have been relatively stable in the past 20 years compared to prices in other sectors, such as housing, education and health (ABS 2014c).

The fact that input prices have outpaced final retail prices is consistent with retailers finding their operations to be more expensive over time relative to their output prices. This, however, would not necessarily have led to lower profitability for the retail sector overall.

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In the past decade, the price index for retail goods was significantly affected by changes in the cost of goods sold, which, in turn, have been affected by exchange rates and other competitive factors. For many retailers, the effect on profitability of rising costs of doing business were partially offset by a fall in the cost of goods sold — particularly from the decreasing prices of imported goods (D’Arcy, Norman and Shan 2012).

Not all retailers would be in a position to take advantage of improvements in import prices — for example, some deal only in domestic products, while others are subject to long-term purchase contracts made under previous (higher) prices. As such, it is important to consider how the retail trade sector has changed operationally over this period, both in response to input price increases and general competitive pressures.

## **Input volumes and costs over time**

Increases in the prices for both labour and intermediate goods are likely to have had some effect on retailers’ use of inputs in volume terms. For example, while the number of employees in retail trade has grown over the past 10 years, there was a significant slump after 2007-08 (figure 3.8, left panel). A similar trend was evident in the number of working hours in retail trade.<sup>14</sup> By 2012-13, the number of people employed in retail trade was around 20 per cent higher than 2000-01 levels, but remained below the 2007-08 peak.

Capital investment in retail trade also experienced a slump in 2007-08, but overall, had grown in the past decade (figure 3.8, right panel). In 2012-13, the retail trade industry as a whole invested around 87 per cent more capital than in 2000-01 in volume terms, although this too remained below the peak in 2007-08.

To some extent, trends in labour and capital volumes have counteracted the trends observed for labour and capital prices. As a result, the shares of operating costs represented by labour and capital have not changed fundamentally in the past ten years (figure 3.5).

## **Input usage and productivity**

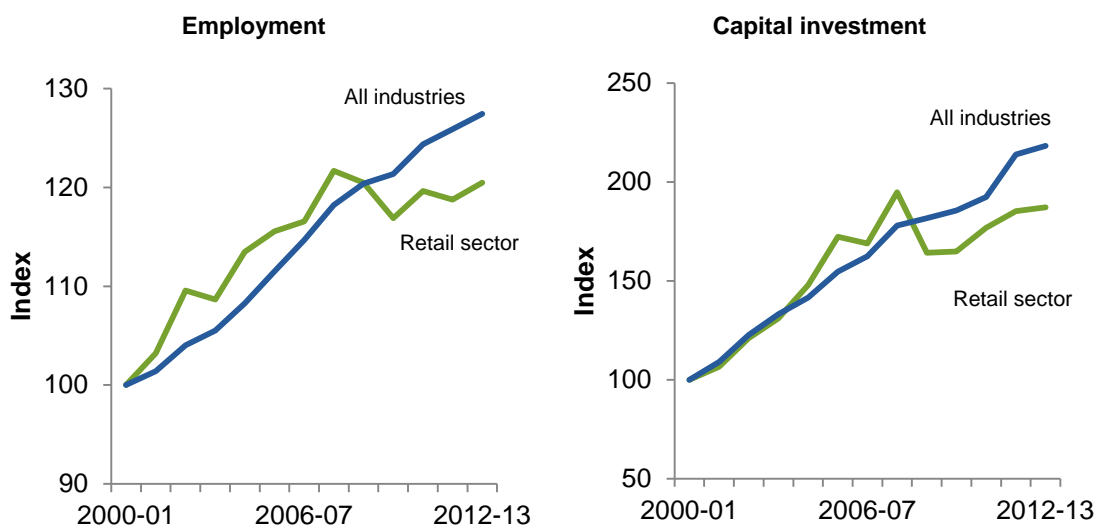
The relatively slow growth in employment of labour since 2007-08 is consistent with productivity gains discussed in chapter 2. Compared to the market sector, retail trade has experienced relatively strong growth in labour productivity and multifactor productivity (figure 3.9). This is consistent with the sector finding operational efficiencies, using less inputs to produce its output. This, as well as changes in the cost of goods sold, would have both been factors in maintaining profitability in recent years.

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<sup>14</sup> While retail trade employed around 1691 million working hours in 2002-03, this rose to a peak of 1906 million hours in 2007-08. After two years in decline, retail trade working hours grew to 1812 million hours in 2012-13 (ABS 2014a).

**Figure 3.8 Employment and capital expenditure are yet to reach pre-GFC levels<sup>a</sup>**

Index 100 = 2000-01

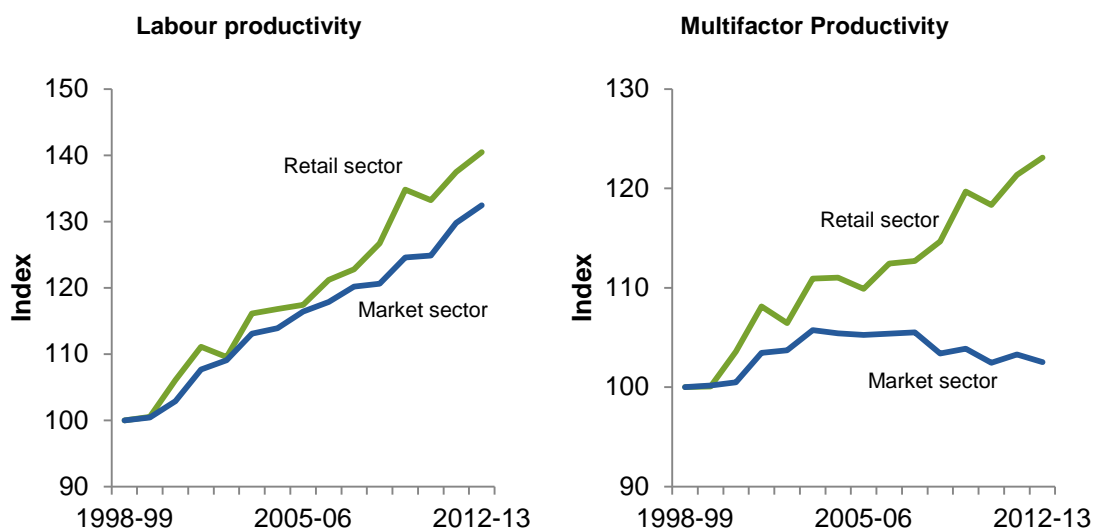


<sup>a</sup> The index of employment is based on the total number of people employed, and includes both part time and full time workers. Capital expenditure is measured as gross fixed capital formation, using chain volume measures.

Sources: ABS (Cat. no. 5204.0, 2013; Cat. no. 6291.5.55.003, 2014).

**Figure 3.9 Productivity growth in retail has been relatively strong**

Index 100 = 1998–99



Source: ABS (Cat. no. 5260.0, 2013).

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#### FINDING 3.2

For retail businesses, labour and intermediate input prices appear to have risen in line with inflation but faster than retail prices.

#### FINDING 3.3

At a broad industry level, retail profit has been relatively stable over time. To some extent, overall profitability has been protected by the lower cost of some goods, reflecting both sourcing strategies by retailers and the appreciation of the Australian dollar. Rising input costs have also been partly offset by productivity gains.

### 3.3 The main cost drivers

While operating expenses are subject to rising prices, they are also affected by changes in business strategy. For example, in a review of 18 listed retailers, BDO (2012) found that between 2010 and 2012, increases in ‘marketing and selling’ expenses were particularly significant — more so than any increases in labour or occupancy costs. They noted that:

... companies, while looking to keep employee and rental costs under control, recognised that they needed to increase their marketing spend in order to maintain their market share. (BDO 2012, p. 10)

This is consistent with the observation that retailers often compete for market share by developing non-price points of difference (chapter 2). As such, competitive pressure can be a significant driver of operating costs.

However, retailers’ operating costs are generally open to any number of cost drivers. While some relate to the retailer’s business decisions and market power, others are heavily influenced by regulatory frameworks. Some of the main cost drivers, particularly those outside of the control of businesses, are discussed in this section and in later chapters.

#### Labour costs include wages and other on-costs

Labour costs include both wages and other on-costs, such as employer contributions to superannuation; workers’ compensation; as well as fringe benefits and payroll taxes. Business decisions that affect overall labour costs include the number of staff hours and the balance of skills and seniority employed. Wages comprise the majority of labour costs across all types of retail businesses, while the relative importance of non-wage labour costs varies between types of retail (table 3.1). Trends in retail wages are discussed further in chapters 4 and 7.

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

\$ million (per cent of total labour costs), 2012–13

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	<i>Wages and salary<sup>a</sup></i>	<i>Other labour costs<sup>b</sup></i>	<i>Total labour costs</i>
Motor vehicle and parts	5 507 (86.0)	898 (14.0)	6 405 (100)
Fuel	1 243 (87.6)	177 (12.4)	1 420 (100)
Food	11 876 (86.1)	1 914 (13.9)	13 790 (100)
Other store-based	21 013 (87.6)	2 969 (12.4)	23 983 (100)
Non-store and commission	796 (88.1)	108 (11.9)	904 (100)
Total retail trade	40 435 (87.0)	6 066 (13.0)	46 502 (100)

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<sup>a</sup> 'Wages and salary' includes capitalised wages and salaries and excludes drawings of working proprietors. <sup>b</sup> Other labour costs includes workers' compensation costs, fringe benefits tax and payroll tax.

Source: ABS (Cat. no. 8622.0, 2014).

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Labour costs are affected by several drivers, particularly wage setting processes and government policy on issues such as superannuation and workers' compensation. They are also subject to business decisions regarding wage rates or the volume of labour employed (box 3.2). For instance, higher wages can result from retailers competing in terms of customer service levels — this may involve hiring more and/or better qualified staff, or paying staff more as a means of incentive management. As such, high wage costs themselves are not necessarily evidence that a firm is performing poorly or not competitive.

## Occupancy costs

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

Occupancy costs tend to be the largest area of expense in retail trade aside from labour costs, though this varies between different areas of retail trade (table 3.2). The determination of occupancy costs is complex — they are not simply a function of sales per square metre of floorspace. Rather, they reflect a number of factors relating to both retail business models and the market for retail real estate.

### Box 3.2 Case studies: some business strategies require higher labour costs

Many retailers pay higher wages as part of their business strategy. For example:

- Some businesses pay above award rates, even though their direct competitors pay award rates. This is likely to help their competitiveness in the labour market and their management incentive structures for their staff.
- Gilmour's uses specialised, trained staff to offer advice to customers on their specialised products, and allows a higher than average staff to customer ratio.
- Some hardware businesses hire qualified former tradespersons to offer product advice to customers. For Bunnings, these qualifications result in a wage premium similar to staff with supervisory responsibilities that is competitive with some trade minimum wages (such as for a plumbing 'journeyman', or in joinery and building trades generally).

Some larger businesses may be willing to pay extra labour costs to simply increase the foot traffic into their stores. For example, Woolworths has run a trial where in-house pharmacists would provide free health checks in supermarkets without providing product advice. These staff would represent an extra labour cost above what might be expected in other retailers, given that they are to perform free services that are not related to sales or store operations.

Sources: Gilmour's (sub. 11); Scott (2014); Bunnings Group (2013); CFMEU (2014); Master Plumbers Association (2013); pers. comm., 16 April 2014.

Table 3.2 Occupancy and rent expenses differ between retail businesses<sup>a</sup>

<i>Business</i>	<i>Occupancy as a proportion of costs of doing business</i>	<i>Occupancy as a proportion of sales</i>	<i>Sales per square metre</i>
	%	%	\$
David Jones	31	10	4 457
Myer	26	8	3 832
Wesfarmers	16	4	8 225
Specialty Fashion Group	33	19	4 027
Premier Investment Group	39	21	6 126
Country Road Group	34	18	na
Harvey Norman	23	22	5 175
JB HiFi	26	4	19 259
Woolworths	15	3	14 549
WA Independent Grocers Association	19	na	na
Pharmacy Guild of Australia	17	5	na

<sup>a</sup> 'na' denotes not available.

Sources: WA Independent Grocers Association, sub. 2; Pharmacy Guild of Australia, sub. DR23; various annual reports 2012-13; Citi (2013).



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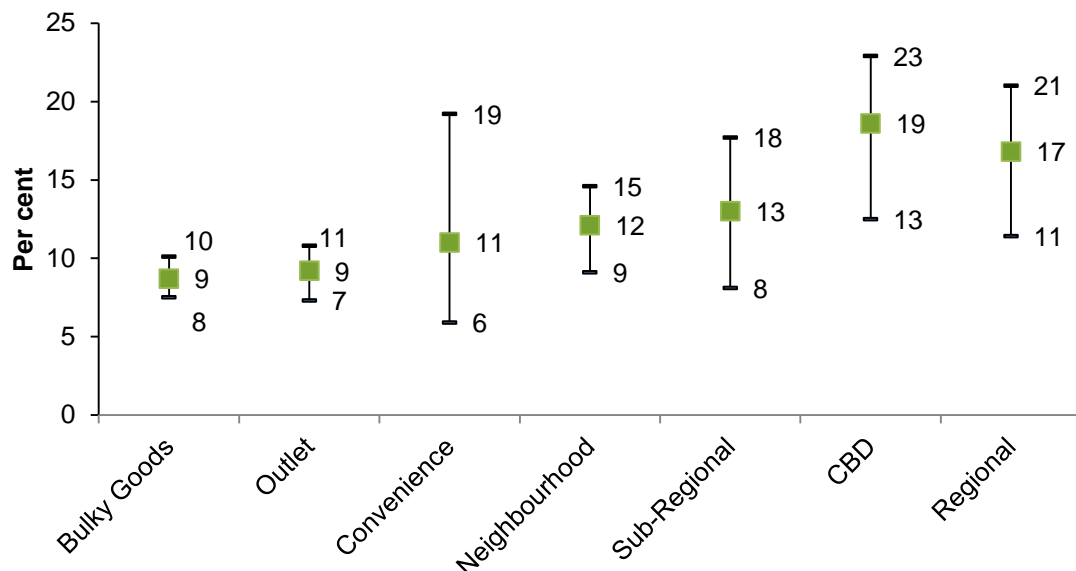
## Several factors determine occupancy costs

Location is a major determinant of occupancy costs (figure 3.10). The highest ratios of occupancy costs to retail turnover are observed for central business district and major regional centres.<sup>15</sup> These findings are generally consistent with the Commission's (2008) report into retail tenancy, which observed that costs per square metre were lower outside of shopping centres and 'prime retail strips'. Retail rents differ between location types due to factors such as local land and property prices; retail profitability (as well as its drivers, such as foot traffic); and relative bargaining power.

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**Figure 3.10 Occupancy cost ratios vary significantly according to location<sup>a</sup>**

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



<sup>a</sup> Occupancy cost ratios are ratios of occupancy costs to turnover. Data relate to Australian listed and unlisted owners of retail property. Figures relate to the simple averages of occupancy cost ratios for each category, and for each property-owning firm. The lowest figure relates to the firm with the lowest average; the highest figure to the firm with the highest average; and the middle figure to the average of all property owning firms. As such, it is entirely possible that particular retailers could have occupancy cost ratios that lie outside these ranges.

Source: Colliers International (2012).

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This is consistent with evidence from stakeholders regarding why larger stores and supermarkets tend to pay less rent per square metre:

- Large format stores are more likely to operate in low-rent environments as opposed to prime real estate.

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<sup>15</sup> Such ratios are not only sensitive to changes in rents, but also in retail sales.

- 
- Supermarkets tend to pay less rent per square metre than other stores in a shopping centre, but tend to rent much larger areas than other stores (up to 30 times the size of a specialty goods store).
  - Supermarkets are often the ‘anchor tenant’ in a shopping centre, and have often signed on much earlier than other shops and for longer term leases (up to 20 years) (Large Format Retail Association, sub. 19; Shopping Centre Council of Australia, sub. DR27).

### Occupancy costs over time

Some stakeholders indicated that rents have been relatively stable in recent years (Large Format Retail Association, sub. 19), although others pointed to increases in retail rents in the past decade (Pharmacy Guild, sub. 12). Colliers International noted that in the decade to 2012, ratios of retailers’ rent costs to turnover had been largely stable (Colliers International 2012, p. 3).

Retail rental costs are subject to several driving factors relating to both the demand for retail floorspace (including demand from outside the retail sector, such as from the services sector), and the supply of retail floorspace. The latter is influenced by planning and zoning regulation, which is a significant issue faced by retail landlords and some larger retailers — discussed in chapter 6.

Colliers International (2012) also noted that occupancy costs *other than rent* have risen. Information from the Shopping Centre Council of Australia supports this view, although it relates only to those retailers in shopping centres rather than the sector more generally (sub. 17, p. 6). It advised that, in nominal terms, per square metre of shop space, from 2009 to 2013:

- electricity costs had risen by 36 per cent
- insurance premiums had risen by 34 per cent
- air conditioning costs had risen by 21 per cent
- common area cleaning costs had risen by 19 per cent
- repairs and maintenance costs had risen by 13 per cent
- security costs had risen by 2 per cent.

These costs are shared among tenants and with the landlords themselves according to the terms of tenancy agreements, which are in turn governed by state legislation. The overall impact of these occupancy cost increases on individual retailers would differ according to such factors as their cost structure, the length of leases and bargaining power.

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## Energy and other utility costs

Energy and utility costs comprise less than 5 per cent of the cost of doing business for the vast majority of retail subdivisions. They are a more significant cost for liquor retailers, supermarkets, hardware stores and grocery stores, comprising between 5-10 per cent of operating costs.<sup>16</sup> Energy prices have increased significantly in recent years, and several participants commented that energy prices were a significant cost issue (box 3.3).

### Box 3.3 Stakeholder comments on utility costs

Several stakeholders have noted that energy and water costs have risen in recent years:

Energy is a crucial essential input for all retailers. ... Whilst the retail sector is one of the largest private employers in Australia it has been a neglected business sector in terms of publicly funded energy efficiency programs and services, unlike the commercial building or the domestic consumer sectors. ... Maintaining our competitive advantage in low cost energy is an important strategic economic and business goal for government. (Swimming Pool and Spa Alliance, sub. 5, pp. 7–8)

... the introduction of the Carbon tax and the ongoing operation of the renewable energy target (RET) have added significant pressure to businesses. (National Retail Association, sub. 18, p. 8)

Energy is an essential cost for our retailers due to the need for refrigeration and cool-rooms in addition to normal retail store lighting, signage and display plus air-conditioning. Whilst many of our members have accessed information and tools via the energy efficiency information project to reduce energy usage and costs, energy will continue to represent a significant cost of liquor retailing. (Australian Liquor Stores Association, sub. DR31, p. 5)

The WA Independent Grocers Association provided an example that shows larger consumers of electricity may pay lower prices per kWh:

Public policy also impacts on the disproportionate rate that smaller retailers pay for electricity ... We have an example where ... the independent liquor store pays 22 per cent more [per kWh] for electricity to run their lighting and refrigeration verses the supermarket in the same centre. Both charged from the same supplier and the supplier has the same cost to produce electricity and the same cost to deliver the electricity to both outlets. (sub. 2, p. 2)

Both the liquor store and supermarket in question are large enough consumers of electricity that they would have access to a competitive energy market, allowing them to negotiate individually contracted rates. The final agreed price depends on such factors as the volumes of energy demanded by the customer, their usage profile, and a broader set of market conditions at the time of negotiation.

Sources: SPASA, sub. 5; NRA, sub. 18; WAIGA, sub. 2; ALSA, sub. DR31; Alinta Energy, pers. comm., 1 September 2014.

The determination of electricity prices is complex. For instance, retail businesses would pay several separate charges for electricity, including a network tariff, a loss factor charge, an electricity usage charge (which may include peak and off-peak charging), a regulated market charge, and the GST. This means that any comparison of energy costs between retail businesses would need to account for differences in location, as well as the amount and timing of usage. Those requiring 24 hour refrigeration can be expected to incur higher costs, particularly if there are peak and off-peak charges. The overall cost may also be

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<sup>16</sup> IBISWorld unpublished data.

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influenced by the contestability of the electricity retail market in that area, and the ability of businesses to negotiate contracted rates (box 3.3).

Many drivers of electricity prices, particularly those relating to network costs, are discussed at length in the Commission's (2013b) report on Electricity Network Regulatory Frameworks.

## **Delivery and freight costs**

Retailers incur freight costs for the delivery of goods from wholesalers to their stores, as well as (in some instances) delivery costs from their stores to customers' homes. Historically, catalogue and phone-based retail channels would also involve delivery to customers' homes. While today's online retailing does include some 'click and collect', it too is mostly based around delivery. Online retailers are more likely to include a flat rate for shipping or include it as part of the consumer price (that is, 'free' delivery), and may include free returns (Australia Post 2011). For some retailers, freight and delivery are a significant cost component.

The Supply Chain and Logistics Association of Australia (SCLAA, sub. 15) noted that Australia Post is a major carrier for small packages for small to medium businesses, and prices for 500g and 3kg packages have increased by around 55 per cent in nominal terms since 2009.<sup>17</sup> This is likely to affect smaller businesses more than larger ones, as retailers who deliver higher volumes are likely to be able to access a negotiated postage rate.

As a Government Business Enterprise, Australia Post sets their own prices according to corporate objectives — recent price increases are reportedly reflective of costs such as transportation and labour (sub. DR38). Australia Post are also open to competition from other transport companies. The SCLAA acknowledges that several other couriers provide delivery on these packages — for a range of packages between 500g to 25kg, couriers can be up to 22 to 47 per cent cheaper than Australia Post (sub. 15, p. 4). However, it argues that Australia Post is a price leader in this field and its price increases have therefore contributed to higher costs across the board.

As such, while price increases implemented by Australia Post are likely to affect smaller retailers, the overall impact on retailers is unclear, given the scope for some retailers to negotiate rates with Australia Post and the contestable market for parcel delivery.

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<sup>17</sup> ABS (2014c) data show that CPI inflation between June 2009 and June 2013 was around 10.7 per cent, or around 2.8 per cent per year. As such, the increases in 500g and 3kg packages reported by SCLAA (sub. 15) were around 11 per cent per year in real terms.

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### **3.4 How retailers are responding to rising input prices**

There are several examples of the different ways in which retailers are responding to rising input prices. In some cases, retailers have responded directly to input price increases, making operational changes with the specific aim of reducing costs. In other cases, such as where innovative business models have been adopted, retailers may have taken actions to minimise the effects of rising input prices, although their decisions are likely to have been influenced by other factors. For instance, as outlined in chapter 2, retailers are responding to the changing operating environment, and attempting to improve sales revenue and gain market share.

Other businesses appear less able to make operational changes in response to rising input prices. Moreover, while this is not evident in the aggregate data, some retailers are dealing with increases in their cost of doing business through a reduction in profit margins.

#### **A focus on cost cutting measures**

Some businesses have reduced the cost of their goods or their cost of doing business. For example one major supermarket implemented programs that reduced the final retail prices of a select number of goods by 8 per cent on a volume weighted basis — around 2 per cent of the reduction was from a reduction in the cost of goods sold, while the remaining 6 per cent reflected either lower retail margins or greater efficiencies (Deloitte Access Economics 2012, p. iv).

Reducing operating costs can be a complex, long term strategy — for example, David Jones implemented a plan to reduce operating costs over several years (box 3.4).

Some forms of cost reduction can depend on the power to bargain and negotiate. As discussed above, retailers are often able to negotiate contracted rates for such expenses as energy and freight, but only if they are sufficiently large consumers.

A focus on cost cutting is not uncommon among retailers. A survey of retail executives undertaken by Deloitte (2013a) found that 40 per cent of respondents cited ‘cost reduction/efficiencies’ as their highest strategic priority — this compares to less than 25 per cent of respondents in the previous year’s survey (Deloitte 2012, p. 8).

#### **Innovation and growth strategies**

Some innovative business models that have emerged in retail trade have focused more on improving revenue rather than reducing costs. For example, in the late 1990s, Bunnings moved to a DIY-focused, large format store — it involved higher staff levels (hence, higher labour costs) than the previous B&B Hardware stores, with the aim of improving revenue per store (Bunnings Warehouse 2002).

### Box 3.4 Case study: reducing the cost of doing business over a number of years

David Jones achieved a steady reduction in their cost of doing business as a proportion of turnover over the past seven years, with a slight rebound in 2011-12 (figure below). This involved the company identifying 74 cost efficiency initiatives to implement over a number of years, including:

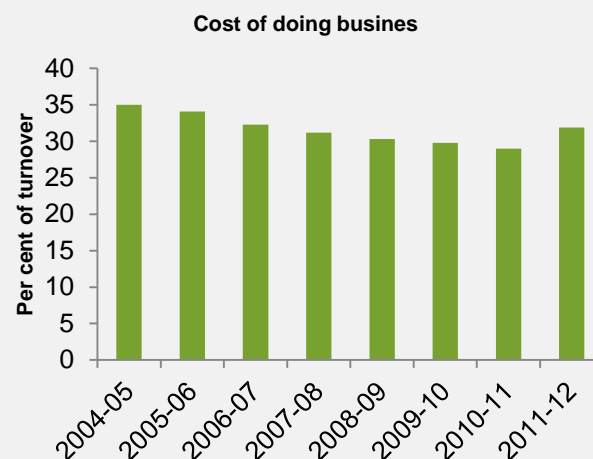
- Using technology to reduce back of store costs (\$4.2 million)
- Centralising packing and shipping tasks for the gift and bridal section (\$1.5 million)
- Improving safety and claims management to reduce workers' compensation expenses (\$1.5 million)
- Improving cash handling procedures (\$1.4 million).

Cost efficiencies often require capital outlays or involve changes to operational practices:

During the year a number of [cost of doing business] initiatives have been implemented that include eliminating administrative tasks through the consolidation of stocktaking activities and the introduction of product scanners within the Company's gift registry business. (David Jones Ltd 2012, p. 4)

The relative increase in the cost of doing business in 2011-12 represented a number of factors, both within and outside of the company's control:

The increase in employee costs reflects increased investment in service, the provision for FY2013 incentive payments and an increase in wage rates in line with the Company's Enterprise Bargaining Agreement. The increase in lease and occupancy costs reflects the opening of the new Highpoint store and higher occupancy costs (e.g. utilities). The higher depreciation charge reflects the Company's significant investment in technology over the past two financial years. (David Jones Ltd 2013, p. 5)



Sources: David Jones Ltd, Full Year Consolidated Financial Reports, 2005–2013; McInnes and Goddard (2008).

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Many of the new business models that have emerged in the sector more recently appear to have some advantage in terms of operating costs. Some retailers have been built around business models that:

- remove wholesalers from the supply chain and deal directly with manufacturers
- combine an element of manufacturing and online retail, such as in customised and tailor made shoes and clothes (such as Shoes of Prey and Institchu)
- create competitive platforms for filling customers' orders, either at the retail level or further up the supply chain (such as Yatango and Alphatise)
- allow online retailers to expand by operating a bricks and mortar showroom or collection point where footwear or clothing can be tried on for size (such as Shoes of Prey and THE ICONIC).

Many innovative business models incorporate some element of online retail, often in combination with traditional retail. Around 38 per cent of retail businesses in Australia have an online presence, though the significance of online sales is still relatively low.<sup>18</sup> Small sample surveys by Deloitte in 2012 and 2013 show that for many businesses, developing multiple retail channels has been a high priority (figure 3.11). Moving online allows retailers to both access markets that were previously out of reach and, potentially, reduce their labour and occupancy costs.

Australia has been ranked as a relatively facilitative environment for online trading for small to medium enterprises. A report by the Economist Intelligence Unit (2014) ranked Australia first out of 19 of the G20 countries in terms of ease of conducting online international trade for small to medium businesses. The ranking was based on indicators of investment climate, internet environment, international trading environment, regulatory and legal framework and e-payments systems.

Many of the reasons cited by stakeholders for *not* trading online revolve around their financial capacity and their attitudes towards online retailing — reflecting a business decision rather than a regulatory barrier. Some of the reasons cited for small retailers' reluctance to embrace online retailing included their beliefs about their competitiveness in the online world; their ability and budget for online expansion; their tendency towards social media in lieu of online trading; and their focus on traditional retailing (Small Business Development Corporation, sub. DR36). Gilmour's (sub. 11) described online retailing as a 'management decision' that did not require government intervention.

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<sup>18</sup> Online retail sales are estimated to account for 2–6 per cent of total retail sales (see chapter 2). Deloitte 2013 found, in a survey of 60 retailers, that 54 per cent of respondents expected that online Christmas sales would comprise less than 2 per cent of all Christmas sales (p. 8).

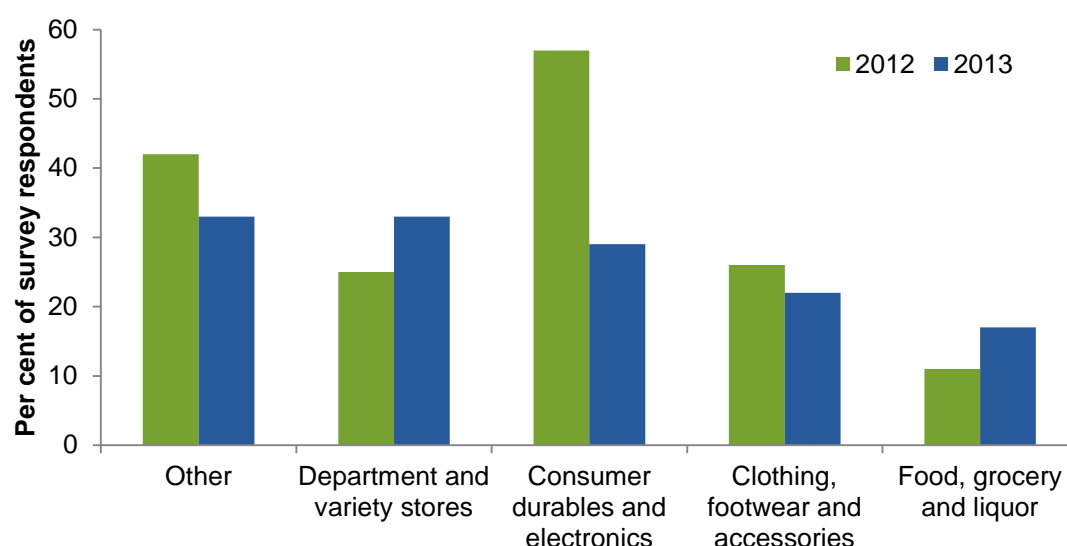
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Although online retailing can potentially achieve sales at lower operating costs than in traditional retail stores, its impact has varied across types of retail. For example, in hardware retailing, Bunnings has noted the threat of Amazon and international online retailers (see chapter 2). Yet, the largest profitable hardware retailers in Australia are yet to facilitate online purchases.<sup>19</sup>

Online retailing has been more successful in areas such as clothing, electronics and flower retailing. Among online retailers themselves, anecdotal evidence suggests that both scale and innovation remain important competitive factors (Fitzsimmons 2013; Ramli 2014). Citi (2011) suggested that the role of scale in online retailing is due to the relative significance of warehousing, distribution and marketing costs, where scale economies are significant.

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**Figure 3.11 Proportion of retailers whose primary focus for the year was expanding omni-channel retailing<sup>a</sup>**



<sup>a</sup> Figures for 2012 are based on a survey of 52 retailers, while figures for 2013 are based on a separate survey of 60 retailers.

Sources: Deloitte (2012, 2013a).

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Although barriers to online retail entry are low, and although Australia is a relatively facilitative environment for small to medium enterprises to trade online, it is not a panacea. Businesses would still be faced with competitive pressures, including from larger retailers.

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<sup>19</sup> At the time of writing, there was no online purchasing available for Bunnings, Mitre10 and Home Hardware. Masters became the first Australian hardware store to allow online purchasing in 2012, but at the time of writing, had not yet been a profitable business.



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## Reducing profit margins and making losses

One of the potential consequences of increasing costs (in the absence of a commensurate increase in revenue) is the erosion of profit margins for individual businesses. Where retail businesses are part of much larger financial concerns, they may be able to operate at a loss for several years — such timelines to profitability often form part of the business plan for a new retail business, such as for Masters or THE ICONIC (Mitchell 2013; Woolworths 2013). Higher costs of doing business and lower profit margins (or losses) may occur where businesses are building towards a profitable scale.

Alternatively, many firms that are making low or negative profits may exit the industry. As noted in chapter 2, many firms exit the industry each year, although the reasons for such exits may or may not be performance related. The National Retail Association note that while many foreign firms have entered the Australian market:

There have been just as many high-profile business failures and collapses of large retail chains and just as importantly, the mostly unreported closure of countless small and micro retail businesses over recent years. This has been true across most sectors of retail – from whitegoods and home wares to fashion. (sub. DR32, p. 3)

Perhaps unsurprisingly, survival rates for smaller retailers tend to be lower than for larger ones. The highest survival rates for retailers from 2009 to 2013 were for retailers earning above \$2 million in turnover, and generally deteriorated in line with decreasing levels of turnover (ABS 2014d). Similarly, those employing more staff tended to have higher survival rates.<sup>20</sup> These results were relatively consistent across different subdivisions of retail trade and across jurisdictions.

As such, while evidence suggests that the profitability of the retail sector as a whole has been relatively stable during the recent increases in input costs, this is not indicative of the ability of individual businesses to deal with such cost pressures.

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<sup>20</sup> From 2009–2013, there were few retailers employing over two hundred staff in Tasmania, the Northern Territory or the ACT. For these jurisdictions, this category of retail businesses would either have no applicable survival rate or a relatively poor survival rate. In the other jurisdictions, where retailers more commonly employ over 200 employees, their survival rates tend to be substantially above the average (ABS 2014d).



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## 4 Cross-country comparisons

### Key points

- International cost comparisons are often difficult due to data limitations and may not provide a robust basis for policy responses. At an aggregate level, the composition of retailers' cost of doing business is similar across broadly comparable countries. Labour costs account for the largest share of the cost of doing business for all retail categories across Australia, the United Kingdom and the United States.
- Numerous participants in this study have argued that retail wages are higher in Australia than in many comparable countries, though others have contested whether this is actually the case. In pinpointing the sources of wage differentials, business stakeholders identified several workplace regulations as particularly important — including penalty rates and higher minimum wages.
- Comparing retail hourly labour costs across countries is problematic and sensitive to the measure used. At market exchange rates, Australian hourly labour costs appear to be higher than in the United Kingdom and the United States, but comparable to those in Germany and the Netherlands.
  - Any cross-country comparison of labour costs needs to take into account the amount of output relative to labour costs. A more relevant measure than hourly labour costs is unit labour costs, which measures average labour costs per unit of output. Labour costs as a share of revenue (a proxy for unit labour costs) are higher, on average, in Australia than in the United Kingdom and the United States. There is considerable variation in labour costs to revenue ratios across retail categories, although to a lesser extent in Australia relative to the United Kingdom and the United States.
- Higher revenue per retail employee partly offsets the comparatively higher hourly wages in Australia. This explains why the divergence between Australia's and other countries' labour costs as a share of revenue is narrower than the divergence in hourly labour costs.
- While not universal, penalty rates and other compensation arrangements for work on rest days are common internationally. In some countries, days off in lieu are used as an alternative to penalty rates.
- Occupancy costs are also a major cost of doing business for most bricks and mortar retailers internationally. However, rent (which is a major component of occupancy costs) as a proportion of the cost of doing business stands out as being relatively high for some retail categories in Australia compared to the United Kingdom and United States, notably for clothing and footwear.
- As a share of revenue, rent also appears to be higher in Australia on average, compared to the United Kingdom and the United States. Again, rent to revenue ratios for some retail categories, such as clothing and footwear appear significantly higher in Australia.

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Stakeholders were particularly interested in international comparisons of retailers' cost of doing business, particularly given that parts of the retail sector are increasingly contestable between domestic and foreign retailers.

The terms of reference ask the Commission to identify areas of cost advantage and disadvantage that Australian retail businesses face relative to international competitors, where relevant. The Commission has taken this to refer to competition from retailers operating overseas that are directly servicing Australian consumers through online platforms and not international companies that have set up retail operations within Australia.

For some retailers, international online competition may not pose much of a threat at present — partly because they enjoy the protection that comes from the nature of the goods (for example, perishability or lack of homogeneity or compatibility) and from relatively high international freight charges. For other retailers already facing online competition (or the threat of online competition) relative costs are one important element in determining their competitiveness.

International cost comparisons are constrained by a number of factors. Contemporary data that allow meaningful comparisons of retail cost structures across countries are limited. The retail sector is very diverse both within and across countries, which means that aggregate data may not provide sufficient granularity to analyse components of the sector. The sector is also constantly evolving. Like-for-like comparisons would require detailed firm-specific information, but this is tightly held given its commercial sensitivity. Converting costs into a common measure is also problematic, given considerable exchange rate volatility, although comparisons of ratios or growth rates across countries can be used to overcome this problem as they are independent of their units of measurement.

Further, interpretation of observed differences needs to take into account a range of country-specific factors and preferences including business models, regulatory settings, resource endowments and societal choices. Typically, costs, such as wages, are determined across the economy more broadly. It is often unclear which factors are responsible for any observed differences. Accordingly, these differences do not necessarily indicate a problem, or a problem amenable to policy change.

The Commission sought data from a variety of sources — many of which provided only anecdotal evidence, or partial evidence based on a small sample. In the absence of other data, the Commission has made extensive use of the IBISWorld dataset.

The choice of comparator countries is, for the most part, limited by the availability of comparable data. For this analysis, most comparisons have been drawn between Australia, the United Kingdom and the United States, although comparisons with other countries have also been cited where available. The United Kingdom and the United States are considered to be broadly comparable to Australia, as they have similar economic structures and consumer preferences, and given the presence of international retailers that operate

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across all three countries. The United Kingdom and the United States are also of particular interest given their prominence in global online retailing.

## 4.1 Cost comparisons

### The composition of retailers' cost of doing business

For the retail industry in aggregate, there are similarities in the composition of the cost of doing business across Australia, the United Kingdom and the United States. Across some subsectors, such as supermarkets, the available data suggest that there are also no major differences in cost structures between Australian retailers and those operating in broadly comparable markets.

Labour is the largest cost component in each of the three countries, while rent also accounts for a major share of the cost of doing business, particularly for retailers with a bricks and mortar presence. At an aggregate level, there are no major differences between these countries in terms of labour cost shares, with Australia's share only slightly higher (figure 4.1).

The share of rent (which generally accounts for the bulk of occupancy costs) in the cost of doing business is higher in Australia than in the United Kingdom and the United States. This ratio stands out as being relatively high for some retail categories in Australia, notably for clothing and footwear. The underlying drivers of these differences are not obvious. The relatively lower uptake of online business models in Australia may be a contributing factor.

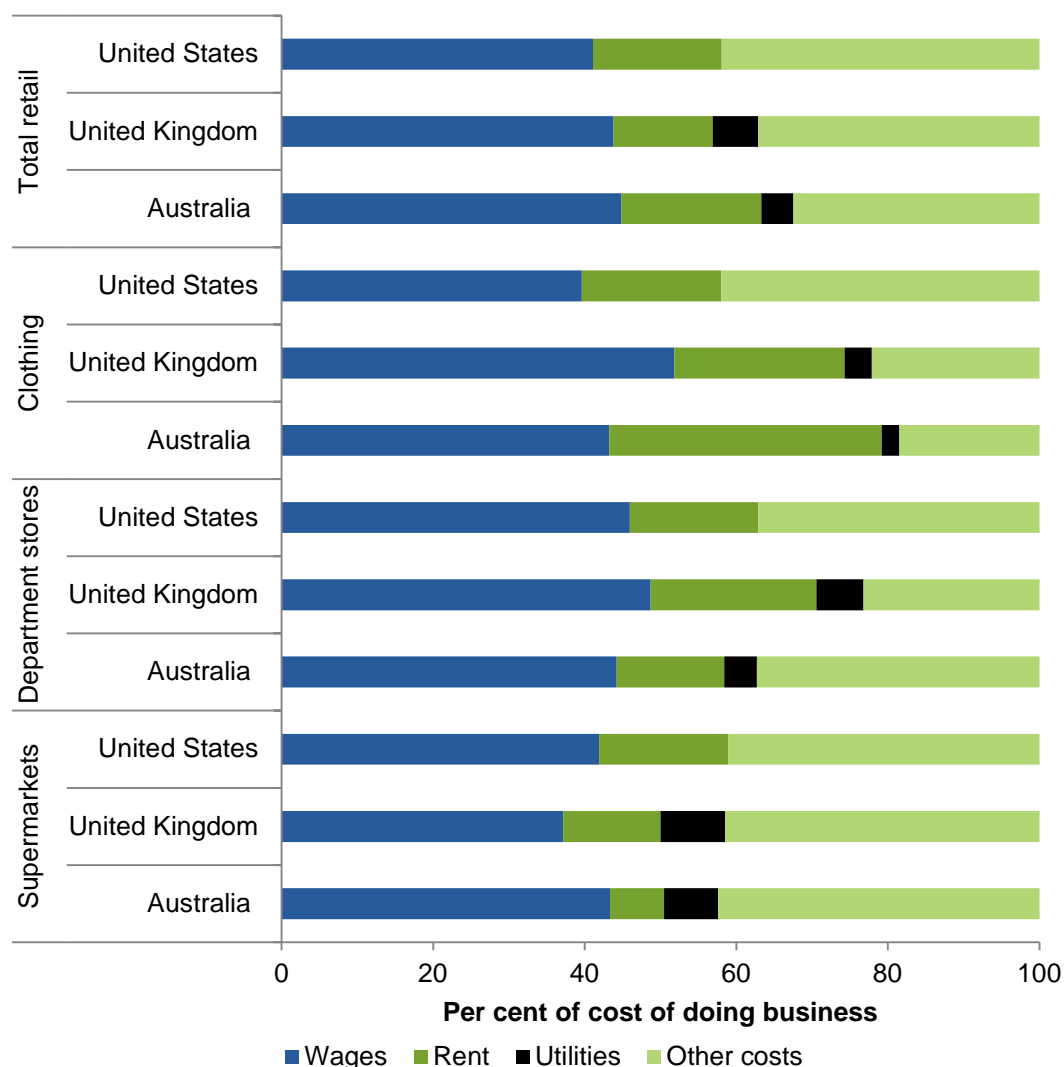
#### FINDING 4.1

There are limited cross-country data on cost structures in the retail sector. On average, cost structures in the retail sector appear broadly comparable across countries, with labour costs accounting for the largest share of the cost of doing business.

At a more disaggregated level, for some retail categories, such as supermarkets, the available data suggest that there are no major differences in cost structures between Australian retailers and those operating in broadly comparable markets in the United Kingdom and the United States. However, for some other retail categories, such as clothing and footwear, differences in cost structures are more apparent. The underlying drivers of these differences are not obvious.

Figure 4.1 **Composition of the cost of doing retail business<sup>a</sup>**

Total retail and selected categories



<sup>a</sup> Retailers' cost of doing business (CDOB) collectively refers to the range of operating costs incurred by retailers and include labour costs, rent and other occupancy costs, and other expenses such as marketing, packaging and administration (among others). Utilities are combined with rent for the United States. Data are estimates for various years — 2013, 2013-14, 2014, depending on the publication date of each industry report. The cost of goods sold, wholesalers' margins and retailers' profits are not included in CDOB.

Source: IBISWorld Industry reports.

## Costs as a share of revenue

The cost of doing business as a share of revenue provides another basis for international comparisons in the retail sector. At the aggregate level, there is little difference in this ratio between Australia, the United Kingdom and the United States. However, at the subsectoral

level, the picture is mixed. For some retail categories, the cost of doing business as a share of revenue is comparable across countries (supermarkets and department stores), while for other categories (clothing), there are larger differences (figure 4.2). The underlying drivers of this divergence are not clear.

**Figure 4.2 Cost of doing business as a share of revenue — total retail and selected categories<sup>a</sup>**



<sup>a</sup> Retailers' cost of doing business collectively refers to the range of operating costs incurred by retailers and include labour costs, rent and other occupancy costs, and other expenses such as marketing, packaging and administration (among others). Data are estimates for various years — 2013, 2013-14, 2014, depending on the publication date of each industry report. The cost of goods sold, wholesalers' margins and retailers' profits are not shown in this figure.

Source: IBISWorld Industry reports.

The above analysis shows that aggregate level data can obscure considerable variability in retail subsectors. Further, there can be considerable variation in cost structures between retailers in the same retail subsector (box 4.1).

#### Box 4.1 A department store comparison

In a comparison of Australian and international department stores, Citi compared David Jones with two US retailers, Nordstrom and Saks; and Myer with the UK retailer John Lewis and the US retailer Macy's.

According to this analysis, the cost of doing business (excluding rent) was lower for the respective Australian businesses. Citi also noted both the relatively low sales density and staffing levels of the Australian department stores. For example, sales on a per square metre basis for John Lewis were estimated at around three times that of Myer. Greater sales density was attributed to fewer stores, much higher staffing, substantial online sales and a sales mix more heavily weighted towards home electronics.

#### International department store comparisons, 2012

Store	Cost of doing business, excluding rent, as a share of revenue <sup>a</sup>	Sales per square metre <sup>b</sup>
	%	\$
David Jones	10.8	3 435
Nordstrom	22.5	4 380
Saks	18.1	4 332
Myer	24.4	2 570
John Lewis	29.0	7 706
Macy's	26.3	1 796

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

Source: Citi (2012).

Higher costs do not necessarily make a business less competitive than a business operating with a lower cost structure. For instance, more expensive fit outs and high levels of sales staff may be profitable for luxury brands where customers value the experience.

One of the notable recent trends in the Australian retail market has been the growth in international high profile retailers establishing a bricks and mortar presence. For example, a Citi comparison of the global and Australian performance for the retailer Zara showed that any cost disadvantages that result in a higher cost of doing business in the Australian market appear to be offset by higher retail prices (table 4.1). This may be partly attributable to Zara's 'newness' and differentiated product offerings.



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**Table 4.1 Comparing Zara's performance, 2012<sup>a</sup>**

	<i>Zara Group</i>	<i>Zara Australia</i>
	%	%
Gross margin	58.6	66.7
Cost of doing business	37.4	41.8
EBIT margin	21.1	24.9

<sup>a</sup> Presented as percentages of revenue. Gross margin is equal to revenue less the cost of goods sold and include retailers' cost of doing business and profit or EBIT (earnings before interest and tax) margin.

Source: Citi (2014).

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## 4.2 Labour costs

Labour costs (including wages, entitlements and other on-costs) are the single largest component of retailers' cost of doing business. Numerous participants in this study have argued that retail wages are higher than in many comparable countries, though others have contested whether this is actually the case (box 4.2). In pinpointing the sources of wage differentials, business stakeholders identified several workplace regulations as particularly important including minimum wages, penalty rates, rigidities in the industrial relations system and the level of employer paid superannuation (see chapter 7 for more on labour cost issues).

### Hourly labour costs

Any cross-country comparison of labour costs requires these costs to be converted from local currency values into a common unit. Two broad approaches are typically used: a common currency at market exchange rates; or a common measure at purchasing power parity (PPP) exchange rates. When comparing labour costs from the perspective of what employees earn, a PPP-based measure is the appropriate choice as it adjusts for differences in price levels in each country and, therefore, accounts for the purchasing power of wages. However, when the focus is on the costs of labour incurred by businesses, as is the case in this study, a common currency at market exchange rates provides a more appropriate basis for comparison.

A comparison of hourly labour costs<sup>21</sup> indicates that, at market exchange rates, average Australian hourly labour costs in the retail sector are currently higher than those in the United Kingdom and the United States. While average hourly labour costs have increased more in Australia than in either the United Kingdom or the United States over the past five years, when compared in a common currency this effect is exacerbated, given the appreciation of the Australian dollar against the other two currencies (figure 4.3). Between

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<sup>21</sup> Labour costs include wages and salaries, as well as other labour 'on costs', such as superannuation or social security contributions, insurance and taxes.

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2008-09 and 2012-13, Australian hourly labour costs in the retail sector grew by an average of 2 per cent per year in Australian dollar terms, and an average of 11 per cent per year when converted into US dollars.

#### **Box 4.2      Participants' views on international labour cost differences**

Numerous participants submitted that Australian labour costs were high by international standards:

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

One sporting goods retailer noted that: 'We pay about ¥1000 (approx. \$10) an hour (more than the minimum wage of about ¥800 (approx. \$8)) at our store in Japan. That's less than half the Australian minimum wage.' (ASGA, sub. 10, p. 6)

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

In relation to wage costs we understand that Australia has one of the highest comparative minimum wage rates in [the] world. The high cost of labour relative to other countries in our region and compared to America and Europe contributes to Australian retailers having a higher proportionate cost for labour in this country compared to others. Labour costs would represent the single highest percentage of the cost of doing business outside of the actual retailer's merchandise. (Large Format Retail Association, sub. 19, p. 6)

Some participants also raised issues such as penalty rates and superannuation:

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

With respect to the international competitiveness of Queensland business in this space, CCIQ urges the Commission to note that Australia has the highest minimum wage globally, a penalty rates regime that impacts on the 24/7 nature of the industry, and the longest running compulsory superannuation scheme in the world. CCIQ believes the collective impacts of such cost impositions on small and medium business is directly affecting their ability to compete with international retailers. (CCIQ, sub. DR29, p. 5)

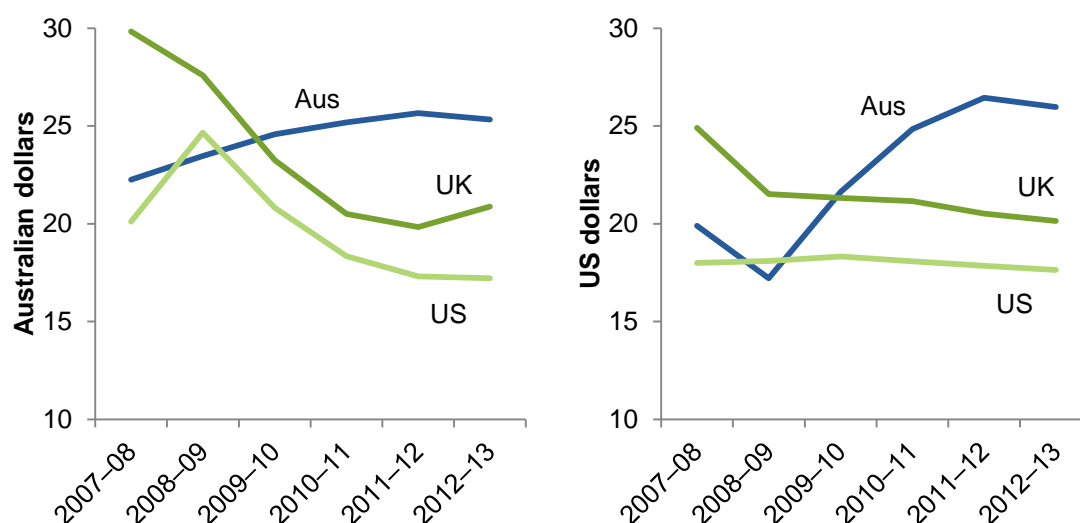
However, the ACTU (sub. DR28) subsequently submitted that:

Australia's hourly labour costs in retail were low in 2007-08, relative to other advanced economies. This does not accord with claims by some employers regarding the relative cost of labour in the retail industry in Australia. (p. 6)

And that:

The suggestion that compulsory superannuation contributions, whether at 9.5% or 12% of earnings, makes Australia 'grossly uncompetitive with the rest of the world' does not accord with the evidence. Almost all OECD countries levy social security contributions and payroll taxes on workers and their employers that far exceed the Superannuation Guarantee. Australia's non-wage labour costs are low by OECD standards. (p. 4)

Figure 4.3 **Average hourly labour costs for retail trade<sup>a</sup>**



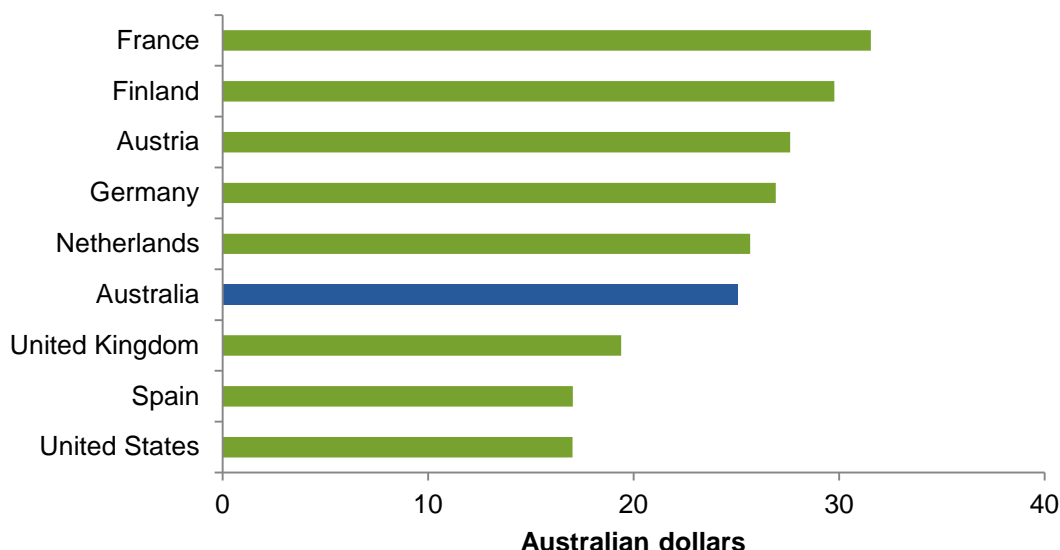
<sup>a</sup> Data are in real (2012-13) terms. United Kingdom is a calendar year series 2008 to 2013 (in 2013 dollars). Over the period, wages and salaries comprised 87 per cent of total labour costs in Australia, 75 per cent in the United States and 89 per cent in the United Kingdom. For Australia, the average hourly cost was derived by dividing total labour costs by the total number of hours worked. For the United Kingdom, the series was calculated using a base 2008 figure and a labour cost growth index.

Sources: ABS (Cat. no. 8155.0, 2012-13; Cat. no. 6291.5.55.003); US Bureau of Labor Statistics (2014); US Census Bureau (2014); UK Office of National Statistics (2013); Eurostat (2014); OECD (2014).

A broader comparison including hourly labour costs for a number of European countries reveals a more mixed picture (figure 4.4). In comparison with these countries, at market exchange rates, Australian hourly costs in the retail sector are around the median, and comparable to those in Germany and the Netherlands.

A key limitation of comparisons of hourly labour costs is that, by themselves, they do not account for differences in the productivity of labour between countries. A cross-country comparison of labour costs needs to take into account how much output is produced relative to labour costs as a retail worker in one country may cost more per hour to employ, but may also be more productive. A relevant measure is unit labour costs — defined as labour costs as a proportion of a given unit or measure of output. Such a measure would ideally use gross value added as the output measure, but revenue, which is more readily available, can be used as a proxy for output. That said, unit labour cost should not be interpreted as a comprehensive measure of cost competitiveness and though important, it should also be considered alongside changes in the cost of capital and of other inputs, such as retail space.

Figure 4.4 **Average hourly labour costs for retail trade, 2012<sup>a</sup>**



<sup>a</sup> Data for Australia and the United States are for 2011-12. Motor vehicle sales are included in data for Australia and the United States, but excluded for other countries.

Sources: ABS (Cat. no. 8155.0, 2012-13; Cat. no. 6291.5.55.003); US Bureau of Labor Statistics (2014); US Census Bureau (2014); UK Office of National Statistics (2013); Eurostat (2014); OECD (2014).

## Labour costs as a share of revenue

In aggregate, the ratio of labour costs to revenue is higher in Australia relative to the United Kingdom and the United States (table 4.2).

Table 4.2 **International retail employment comparison<sup>a</sup>**  
2012-13 (Australia), 2012 (United Kingdom, United States)

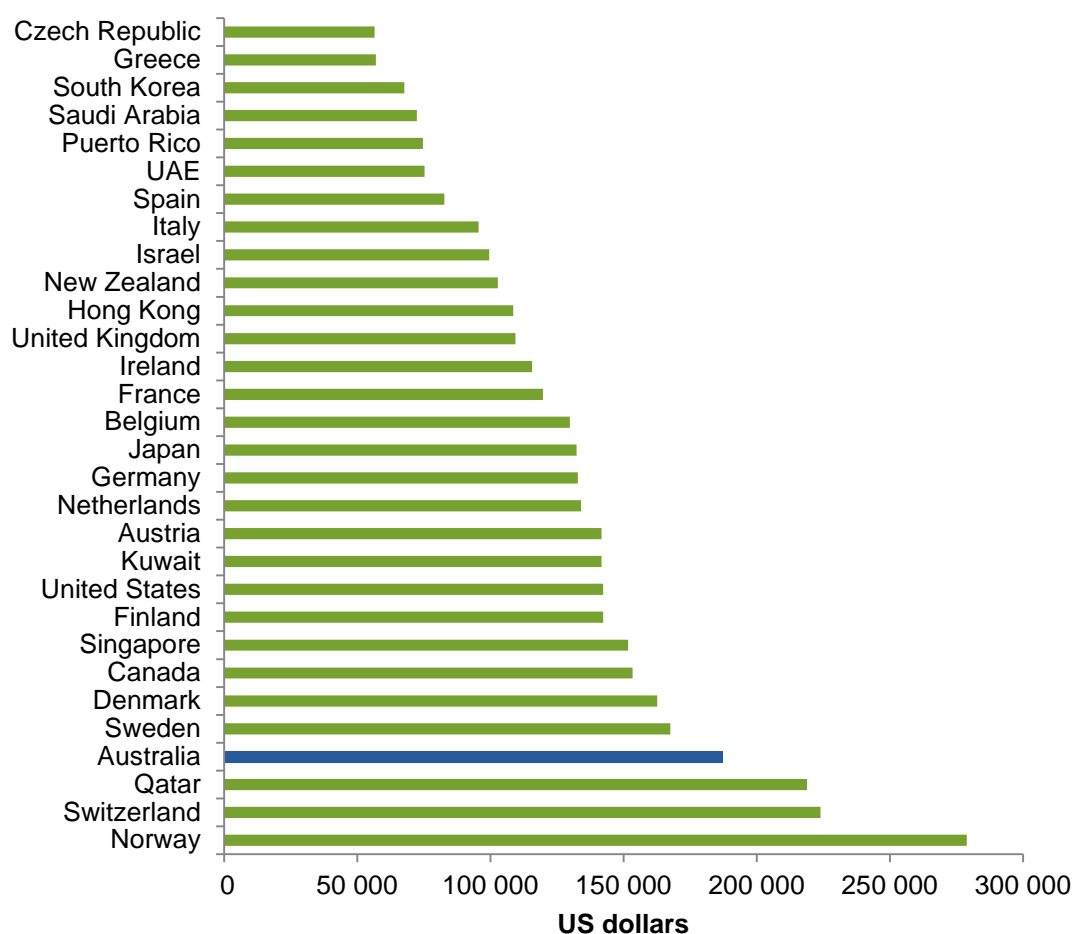
	<i>Australia</i>	<i>United Kingdom</i>	<i>United States</i>
Labour costs as a share of revenue (per cent)	12.1	10.6	11.3
Revenue per employee (AUD)	288 958	210 383	259 316
Total labour costs per employee (AUD)	34 963	22 335	29 354
Revenue per hour worked (AUD)	209	183	150
Total labour costs per hour worked (AUD)	25	19	17

<sup>a</sup> For Australia, unit values are derived from estimates of total labour costs, total hours worked and total number of employees. Employment numbers are based on total employment numbers, including both full and part-time employees.

Sources: ABS (Cat. no. 8155.0, 2012-13; Cat. no. 6291.5.55.003); US Bureau of Labor Statistics (2014); US Census Bureau (2014); UK Office of National Statistics (2013); Eurostat (2014); OECD (2014).

Labour costs, as a share of revenue, are higher in Australia relative to the United Kingdom and the United States, but the divergence is narrower than that observed in hourly labour costs. This reflects the higher revenue generated per hour worked by Australian retail employees, which partly offsets their higher hourly wages (table 4.2). This is also supported by evidence from a more specific comparison of ‘family clothing’ retailers (figure 4.5).

**Figure 4.5 Estimated sales per employee (‘family clothing’ retailers), 2014<sup>a</sup>**



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

Source: Barnes Reports (2014).

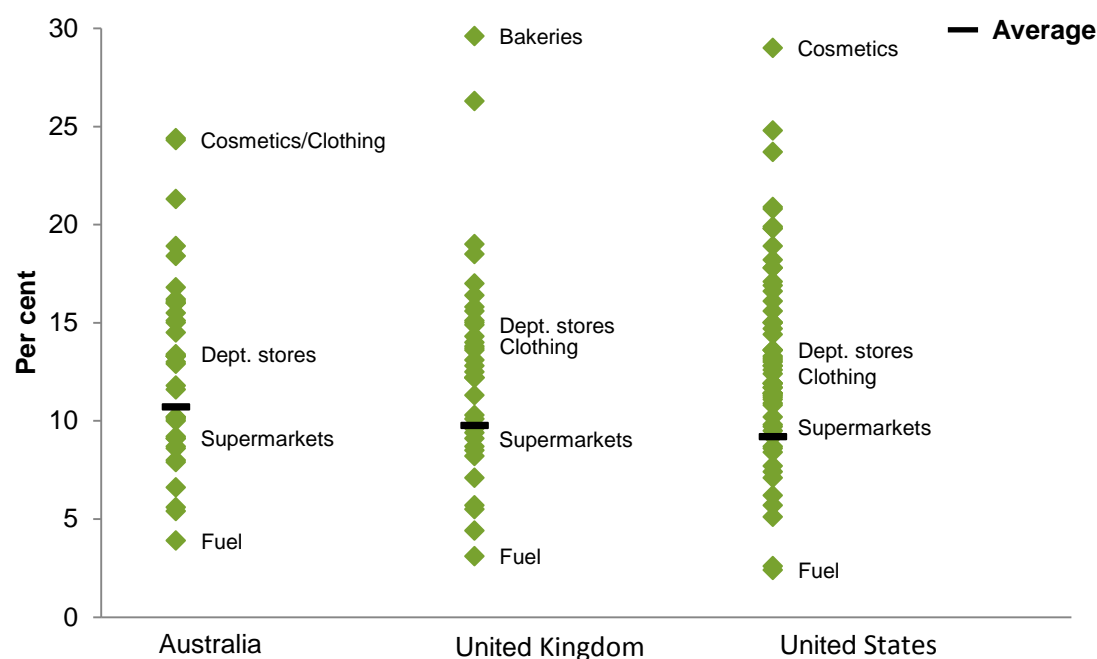
While there is some divergence in the wage cost to revenue ratio between Australia, the United Kingdom and the United States for the retail sector as a whole, there is considerable variation across retail categories within those countries, and for some categories across countries. Nonetheless, the distribution of these ratios appears to fall within a narrower range in Australia than in the United Kingdom and the United States.

Figure 4.6 shows the distribution of IBISWorld estimated wage cost shares as a percentage of revenue for a wide selection of retail categories in Australia, the United Kingdom and the United States. While IBISWorld data are based on wage costs rather than total labour costs, the data are broadly comparable (in aggregate) to the labour cost ratios sourced from national statistical agencies as presented in table 4.2.

- The highest wages to revenue ratios are estimated for: cosmetics and clothing retailers (Australia); bakeries (United Kingdom); and cosmetics (United States).
- The lowest estimated wages to revenue ratios are for fuel retailers in all three countries.

Higher wage cost to revenue ratios tend to be associated with higher service levels, more specialised staff skills or a significant degree of product transformation by retailers.

**Figure 4.6 Wages as a share of revenue<sup>a</sup>**



<sup>a</sup> Data points represent the estimated wage costs, as a share of revenue for different retail categories in each country. The average is calculated as the revenue-weighted average of all retail categories for each country. Data comprise estimates for 63 US retail categories (there is a higher level of disaggregation of the US retail sector), 38 UK retail categories and 37 Australian retail categories. Data are estimates for various years — 2013, 2013-14, 2014.

Source: IBISWorld Industry reports.

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#### FINDING 4.2

On average, the ratio of wages to revenue (a proxy for unit labour costs) is higher in Australia compared to the United Kingdom and the United States. While this ratio varies considerably across different types of retailers, there is relatively less variability in Australia. On the basis of limited available data, labour costs to revenue ratios appear notably higher for clothing and footwear retailers operating in Australia.

### **Penalty rate arrangements vary across countries**

Another issue in comparing international labour costs is the application of penalty rates. Penalty rates are not unique to the retail sector, and in general, there is a range of different approaches to compensating employees for working on rest days and public holidays (table 4.3). Penalty rates are higher in Australia compared to some countries, although other countries, such as Finland and France, appear to have similar compensation provisions. Penalty rates do not apply at all in most parts of the United States.

In other countries, such as the United Kingdom, a weekly rest day is a statutory provision, but this need not be scheduled for the weekend. The provision of days off in lieu can have the advantage of allowing businesses to schedule days off for less busy times of the week. However, where days off in lieu are also paid, they can equate to substantial penalty rates.

The arrangements outlined in table 4.3 should be viewed as indicative only, as there are numerous exceptions and alternative arrangements available to businesses — such as collective agreements — that mean that retail workers in these different countries could be employed under different conditions to those indicated in the table.

**Table 4.3 Compensation for work on rest days and public holidays in selected OECD countries<sup>a</sup>**

<i>Country</i>	<i>Compensation Provided</i>
Australia <sup>b</sup>	Saturday — permanent employees 25 per cent and casual employees 10 per cent loading. Sunday — permanent and casual employees receive a 100 per cent loading. Public Holidays — permanent and casual employees receive a 150 per cent loading. In addition, casuals receive a standard 25 per cent loading (except on Sunday and public holidays). (Permanent employees also receive a 25 per cent loading for weekday work after 6 pm.)
Austria	Rest period must include Sunday and must begin at the latest on Saturday at 1 pm. Time off in lieu for working in rest period must be granted within the same calendar week.
Belgium	Employees working on a Sunday must receive a day off in lieu within six days. If the work was in excess of four hours on the Sunday, a whole day in lieu is to be granted. For work on Sunday of less than four hours a half day in lieu is to be granted. (In retail trades, employees may be employed between 8 and 12 am.) Compensation for work on public holidays is treated the same as for Sunday work.
Canada	Work on a public holiday attracts a loading of at least 50 per cent.
Finland	Work on Sunday attracts a 100 per cent loading.
France	Payment for work on Sunday can be double the normal rate, plus a day off in lieu.
Germany	A day off in lieu is granted for work on a Sunday. For work on a public holiday an employee is entitled to an additional day's pay, time off in lieu or an additional day's annual leave.
Ireland	Compensation for work on Sunday is additional pay specified as a 'reasonable amount' and/or time off in lieu. Work on a public holiday attracts an additional day's pay or time off in lieu.
Japan	No specified rest day. Work on rest day attracts a loading in the range of 25 to 50 per cent.
Netherlands	No statutory provisions as to payment for working on rest days or public holidays.
New Zealand	Payment for Sunday work is agreed to by the employer and employee in the employment contract or collective agreement. For work on public holidays a loading of 50 per cent applies and a day off in lieu.
Sweden	Time off in lieu applies for work on rest days (which will take place on weekends, to the extent possible).
Switzerland	Rest period is Saturday 11 pm to Sunday 11 pm. A loading of 50 per cent applies where work on the rest day is authorized on a temporary basis.
United Kingdom	Time off in lieu for work during a rest period.
United States	There are no Federal general statutory provisions. In a small number of states a loading applies for work on Sunday, for example, in Rhode Island, Kentucky and Massachusetts a 50 per cent loading applies.

<sup>a</sup> For countries other than Australia, the information provided is either for 2011 or 2012. The information for most jurisdictions is based on the statutory provisions contained in the ILO legal database applying to compensation for work undertaken on rest days and/or public holidays and is not retail specific. The level of compensation may vary due to state or provincial legislation or through the use of collective agreements. <sup>b</sup> In Australia, compensation for work on rest days and public holidays is specified in the relevant modern award and the information in the table is specific to employees in the Australian retail sector.

*Sources:* General Retail Industry Award 2010; International Labour Organization (2014); PC (2011a).



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## 4.3 Occupancy costs

As discussed in chapter 3, occupancy costs often represent a significant share of a retailer's cost of doing business, although this varies across retail subsectors. High occupancy costs in Australia, compared to other countries, was raised as a concern by some participants (box 4.3).

### **Box 4.3      Participants' views on international occupancy cost differences**

The Pharmacy Guild of Australia submitted that:

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

While the Shopping Centre Council of Australia stated that a report they had commissioned found that:

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

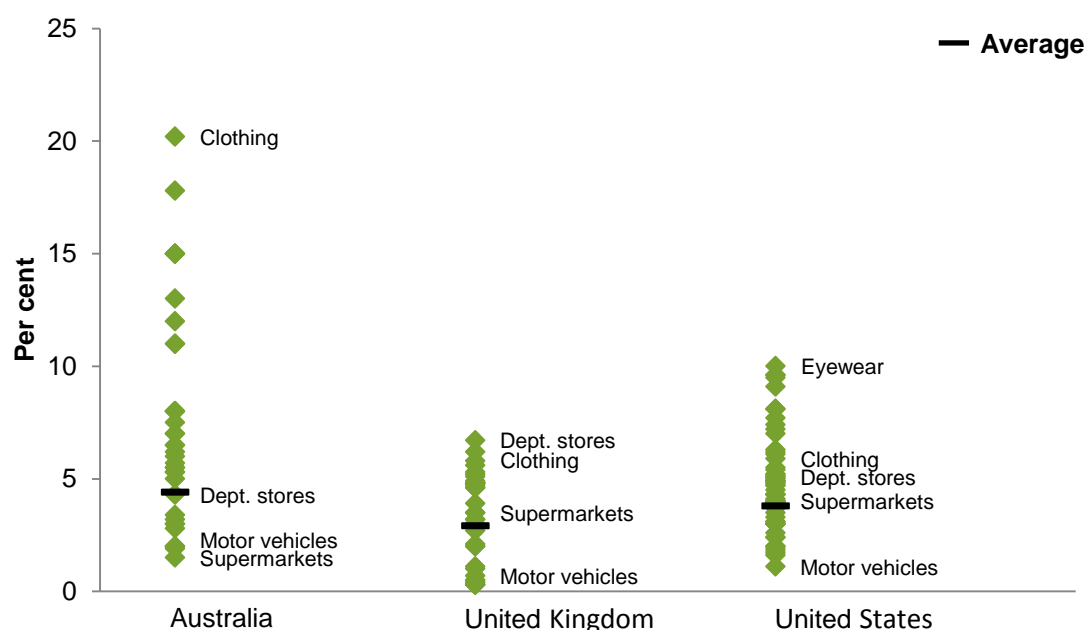
As previously discussed, the average cost structure for different retail categories varies considerably, in Australia and other countries. Figure 4.7 shows the distribution of estimated rent to revenue ratios for a range of retail categories in Australia, the United Kingdom and the United States.<sup>22</sup> On average, rent as a share of revenue is higher in Australia compared to the United Kingdom and the United States. While the ratio varies across different categories of retailers in all three countries, this variation is much more pronounced in Australia.

In the United Kingdom, department stores have the highest ratio, while motor vehicle dealers have the lowest ratio. In the United States, the highest ratio is for eyewear retailers, while the lowest is for motor vehicle dealers. In Australia, motor vehicle dealers are similarly at the lower end of the spectrum. However, at the upper end of the distribution categories such as clothing, footwear and furniture retailers display a substantially higher rent to revenue ratio than both the industrywide Australian average, and the comparable categories in the United Kingdom and the United States.

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<sup>22</sup> Rent is only a part of occupancy costs. Occupancy costs is a broader concept that includes, amongst others, rates, insurance and interest payments, which are incurred by retailers that own, rather than lease, their premises.

Figure 4.7 Rent as a share of revenue<sup>a</sup>



<sup>a</sup> Data points represent the estimated rent costs, as a share of revenue for different retail categories in each country. The average is calculated as the revenue-weighted average of all retail categories for each country. Data comprise estimates for 63 US retail categories (there is a higher level of disaggregation of the US retail sector), 38 UK retail categories and 37 Australian retail categories. Data are estimates for various years — 2013, 2013-14, 2014. Utilities are combined with rent for the United States.

Source: IBISWorld Industry reports.

Data on specialty stores' rent from Westfield shopping centres also suggest that occupancy costs (at least for certain retail categories) in Australia are relatively high, both in per square metre terms and as a proportion of sales (table 4.4). As a share of sales, occupancy costs for specialty stores in Australian shopping centres are around a third higher than in the United States and the United Kingdom.

Table 4.4 Westfield shopping centre performance by country, 2013<sup>a</sup>

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

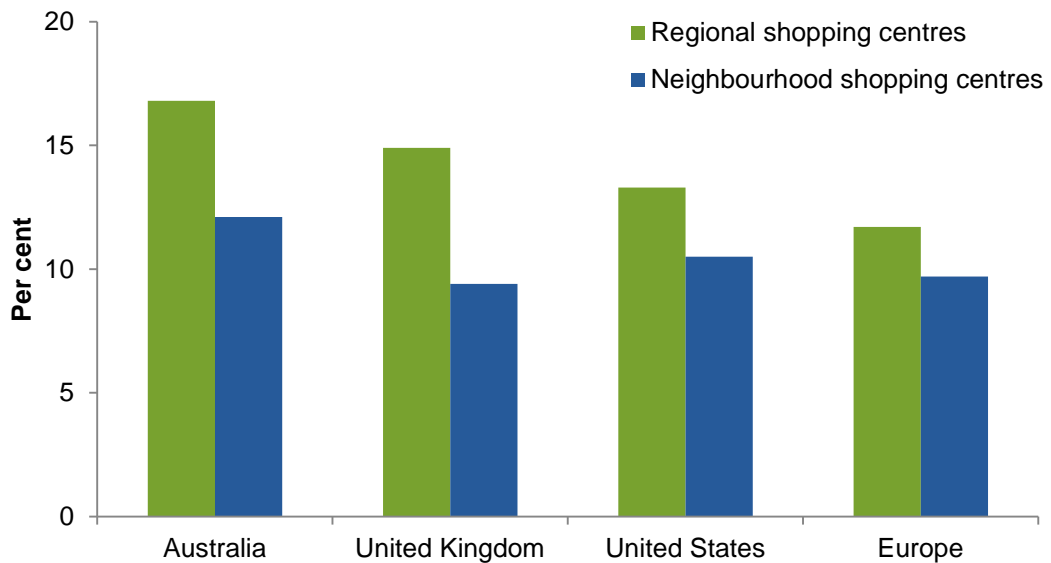
<sup>a</sup> Values converted to Australian dollars using exchange rates listed in publication. Occupancy cost percentage is reported as a combined figure for Australia and New Zealand.

Source: Westfield (2014).

An analysis by Colliers International comparing occupancy cost to revenue ratios in both ‘regional’ and smaller ‘neighbourhood’ shopping centres indicates that overall occupancy costs are also higher in Australia than in the United Kingdom, the United States and across Europe (figure 4.8).

**Figure 4.8 Occupancy cost ratios by region, 2012<sup>a</sup>**

Share of sales revenue



<sup>a</sup>Occupancy cost ratios are occupancy costs (rent and other costs) as a share of sales revenue.

Source: Colliers International (2012).

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

#### FINDING 4.3

On average, occupancy costs (including rent) as a share of revenue are higher in Australia compared to the United Kingdom and the United States. While this ratio varies considerably across different types of retailers, there is relatively more variability in Australia. On the basis of limited available data, rent to revenue ratios appear notably higher for clothing, footwear and furniture retailers operating in Australia.

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## 4.4 Developments in online retailing

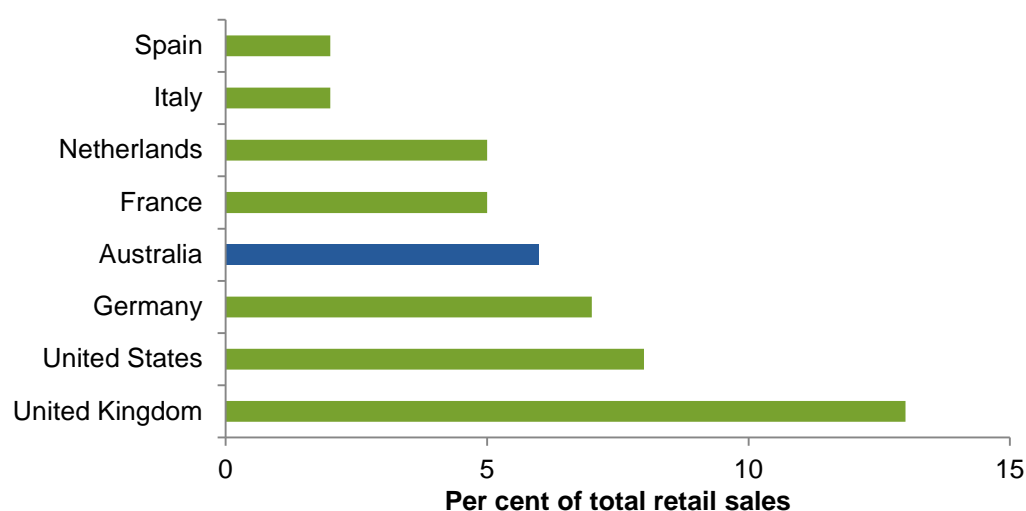
There is a common view that Australia is lagging behind in the adoption of online retailing. For example, eBay submitted to the Australian Government competition policy review that:

The Australian retail industry is widely considered to be lagging behind international counterparts when it comes to adopting multi-channel retail strategies. An Experian report carried out in 2012 found that ‘there appears to be a reluctance among retailers to divert attention (and budget) away from traditional sales channels’. eBay’s seller survey results support this perspective, with 34% of sellers reporting that they face pressure from suppliers not to sell their products at all online or alternatively not to sell on specific identified websites. (eBay 2014, p. 4)

A comparison of online sales as a share of total retail sales shows that it is lower in Australia than in the United Kingdom, the United States and Germany, but higher than in some other European countries such as France and the Netherlands (figure 4.9).

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Figure 4.9 International online sales penetration<sup>a</sup>



<sup>a</sup> The Australian figure is the midpoint of estimates by the Commonwealth Bank and National Australia Bank.

Sources: Bachl and Koll (2013); NAB (2014a); Commonwealth Bank (2014).

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Another indicator of online retail performance is revenue generated online. In a study of the top 50 retailers by online sales revenue, the majority (28) were US companies, followed by UK companies with 9 in the top 50 (Deloitte 2014).

Other studies have suggested that while Australian retailers’ online presence provides online purchasing and access to product information, Australian retailers are lagging

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international industry market leaders in effective online engagement with customers and maintaining customer loyalty (see chapter 2).

### Costs for online retailers

The composition of online retailers' cost structures can be expected to differ from that of traditional bricks and mortar retailers, despite a paucity of data on cost structures of online retailers. While online retailers generally have a cost advantage by not operating physical stores, they can have significant warehousing and distribution costs — depending on their business model (such as their shipping and returns policies).

The online retail market encompasses a range of different business models, including those that are purely online and those that operate across multiple channels. Citi (2011) noted that many of the most successful online sellers in the United States were multi-channel retailers, but in Australia the online sales penetration of the major listed retailers was relatively low, although this analysis may be dated given the rapid evolution of online retailing. The New Zealand Productivity Commission (2014) also noted that some US retailers are reducing their store footprint and increasing online sales in a move to compete with online only retailers.



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## 5 Trading hours

### Key points

- Trading hours restrictions, whether by time of day, day of the week, public holiday, geographic location, size and product line sold, have created a patchwork of regulation across and within jurisdictions, forcing costly adjustments to retailer operations and increasing their costs, while reducing choice and convenience for consumers.
- Restrictions are also increasingly out of step with changing patterns of work, leisure and shopping, and technology that allows consumers to shop 24 hours a day, seven days a week.
- The Commission's 2011 retail inquiry recommended the full deregulation of retail trading hours in all states, including on public holidays.
- Trading hours remain the most restricted in Queensland, Western Australia and South Australia. These jurisdictions have not pressed on with statewide reforms to deregulate trading hours since 2011 and overall they have shown a weak appetite for reform. Jurisdictions' piecemeal approach to deregulation has increased the variability of location-specific arrangements around the country and sharpened the comparative disadvantage of those retailers and consumers outside the areas where trading hours have been extended.
- Recent experience shows that relaxing retail trading restrictions has capitalised on latent consumer demand and allowed consumers to shop according to their preferences as determined by their work, leisure and family commitments. It also increases the scope for businesses to achieve scale economies and reduces red tape.
- Despite concerns that deregulation of bricks and mortar retailing would create extremes in trading hours (for example, 24 hour trading), it has not led to 24 hour a day, seven days a week trading in jurisdictions with unrestricted trading hours. Instead, bricks and mortar retailers are able to open when they consider it is in their commercial interests and opening hours reflect consumers' shopping patterns.
- While the protection of small business is often put forward as a rationale for restricting trading hours, it does not appear to have a material impact on the viability of small businesses in the retail sector. From an economywide perspective, trading hours reform should be a priority, but this is unlikely to be achieved without the political commitment of individual jurisdictions.

### 5.1 Issues

Trading hours restrictions constrain the behaviour of retailers and consumers resulting in higher retailer costs, losses to productivity and economic activity, and lower consumer welfare.

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A retailer forced to close earlier than desired suffers from a less efficient use of capital. Moreover, being forced to close on Sundays, for example, prevents retailers from managing their stocks better, especially those of highly perishable goods like fruit and vegetables. More produce is wasted.

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

Trading hours restrictions reduce the capacity of some retailers to respond to the preferences of consumers, and provide less choice as to when and where they can shop. At a time when consumers are changing their shopping patterns towards smaller more frequent shopping trips and online purchasing, trading hours restrictions are increasingly out of step with community expectations and restrict the industry's ability to adapt and compete with online competitors.

As retail is a significant sector of the economy, the costs imposed on retail businesses and consumers from trading hours restrictions continue to increase over time.

## **5.2 Progress since 2011**

The Commission examined retail trading hours in its 2011 retail inquiry and recommended:

Retail trading hours should be fully deregulated in all states (including on public holidays) (recommendation 10.1). (PC 2011a)

The Australian Government noted the recommendation and stated that retail trading hours are primarily the responsibility of the state and territory governments, and that National Competition Policy reforms had encouraged the deregulation of retail trading hours.

However, participants in this study have generally been critical of the slow pace of changes to trading hours regulation and the impact of trading hours restrictions (boxes 5.1, 5.2 and 5.3).

Trading hours are already effectively deregulated in Victoria, Tasmania, the Northern Territory and the ACT, and largely unrestricted in New South Wales. They remain most restricted in Queensland, Western Australia and South Australia, and within each of these jurisdictions there are widespread inconsistencies.

Jurisdictions with the most restricted trading hours have not pressed on with statewide reforms to deregulate trading hours since 2011 and instead have mostly adopted a location-specific approach (table 5.1). Overall, the appetite for reform has been weak.



**Table 5.1 Trading hours changes since 2011**

<i>Jurisdiction</i>	<i>Year</i>	<i>Proposed change</i>	<i>Rationale</i>	<i>Status of change</i>
New South Wales	2012	Boxing Day trading; permit receipt and unpacking of goods on restricted trading days; arrangements for shops in tourist areas to trade on restricted trading days.	Convenience for shoppers, flexibility for businesses, opportunities for more jobs and income for employees, retail productivity, tourism	Legislation withdrawn as it did not have the support of the Legislative Council
	2013	Retail and food beverage premises trading for 24 hours in the two weeks prior to Christmas Day without requiring planning approval	Reducing red tape	Implemented
Queensland	2013	Queensland Competition Authority review recommends full deregulation of retail trading hours in Queensland as a priority reform	Net benefit of \$200 million a year	The Queensland Government states it is generally satisfied with the current arrangements
Western Australia	2012	Sunday trading in the Perth metropolitan area	Community support for Sunday trading	Implemented
	2014	Expand the definition of a small retail shop	Enable retailers to expand their operations and employ more staff	Before the Legislative Assembly
	2014	Economic Regulation Authority inquiry into Microeconomic Reform recommends full deregulation	No economic justification to retain restrictions	Final report provided to the Western Australian Government in June 2014
South Australia	2012	Public holiday trading in the Adelaide central business district	Contribute to a 'vibrant' Adelaide while balancing family and community activities	Implemented

*Sources:* Baird (2012), Hazzard (2013), Department of Commerce (WA) nd, ERA (2014b), Mischin (2013), Parliament of New South Wales nd, Premier of New South Wales (sub. DR30), Queensland Government (sub. DR37), Wortley (2012).

In Queensland and Western Australia, independent economic reviews of trading hours have supported full deregulation because it provides economic benefits. Despite this, the Queensland Government is generally satisfied with its current trading hours arrangements (sub. DR37), while the Premier of Western Australia said in June 2014 that:

I think [full deregulation is] probably 10 years away. I think it will eventually end up there, but I don't think we have to rush it and as I say, apart from some of the large retail chains, I don't get people writing to me or coming up to me calling for more shopping hours. (Barnett and Phillips 2014)

Many participants in this study also argued that trading hours reform should remain a priority.

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In September 2014, the Competition Policy Review Panel's draft report noted that the deregulation of retail trading hours had benefited consumers (Competition Policy Review Panel 2014b). The draft report recommended the removal of remaining restrictions on trading hours, and where jurisdictions chose to retain restrictions, that these should be limited to Christmas Day, Good Friday and the morning of ANZAC Day (Competition Policy Review Panel 2014b).

### **5.3 The effects of restrictions**

The ad hoc approach of governments to the deregulation of trading hours has created a patchwork of regulations across and within jurisdictions. In some cases, very partial changes have intensified distortions in consumer and business behaviour. The costs of restricted trading hours revolve around:

- the loss in economic activity from lower sales
- the increase in retailers' cost of doing business
- restricted consumer choice and convenience
- distortions in business and consumer behaviour arising from boundary anomalies and inconsistencies
- the reduction in competition arising from the protection of particular types of retailers who are not subject to trading hours restrictions.

#### **Economic effects**

Trading hours restrictions arose in response to cultural and social expectations that are decades, and in some cases centuries, old. Restrictions on Sunday trading in Western Australia date from 17<sup>th</sup> century English laws and, although reformed in part, these restrictions have persisted for hundreds of years (Atkins 2011). In South Australia, regulation was introduced in the early 20<sup>th</sup> century to protect shop assistants from working long hours while providing for those (for example, farmers) who might have to travel long distances to shops (Moss 2007). In New South Wales, trading hours laws maintain exemptions for holiday destinations that were first enacted in the 1960s in legislation that has since been repealed (NSW Government — Finance & Services 2012).

These restrictions are increasingly out of step with changing patterns of work, leisure and shopping as shown by the widespread take-up of extended shopping hours. Technological developments also allow consumers to shop online 24 hours a day, seven days a week.

Restricted trading hours also impose costs on retailers and the economy more broadly in terms of forgone sales and higher operational and capital costs (for example, to accommodate spikes in shopping activity around opening and closing times). Increased trading hours would allow a firm to spread its fixed costs over a potentially larger volume

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of sales, leading to lower average costs. An increase in scale may also enable a retailer to adopt a technology with a lower unit cost of operation or provide customers with a wider range of offerings.

Removing trading hours restrictions provides flexibility for stores to open when it is profitable to do so, for example, in response to consumer demand arising from local conditions such as seasonal variations and community festivals (Woolworths, sub. 13). It also reduces the costs associated with congestion arising from more concentrated shopping traffic. More broadly it provides an overall increase in economic activity.

The Commission received submissions from the Shop, Distributive and Allied Employees' Association (SDA) and Master Grocers Australia / Liquor Retailers Australia who questioned the economic benefits of increased trading hours on the basis that it would not increase retail spending or industry profitability (sub. 6 and sub. DR26).

However, recent experience with deregulation indicates that relaxing retail restrictions can increase economic activity by capitalising on latent consumer demand.

#### **Box 5.1      Participants' views on the impact of trading hours**

International visitors expect an after-hours retail shopping experience, where this option is unavailable; visitors are less likely to engage in other associated entertainment activities (e.g. dining out). (Austrade, sub. DR34, p. 3)

The retail industry is labour intensive and operates on low profit margins ... given the growth in online retailing, cost increases cannot be passed on in full to the consumer as this can result in the consumer bypassing the retailer by purchasing their goods and services online. Shop trading hour restrictions operate in a similar manner and further disadvantage local retail businesses ... (Business SA, sub. DR24, p. 1)

[Businesses] are forced to forego trade, which is directed to other retailers or in some industries, online overseas shopping. (Chamber of Commerce and Industry Queensland, sub. DR29, p. 6)

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

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

In Perth, a 2013 survey showed 84 per cent of consumers had taken advantage of Sunday trading since its introduction in 2012 (CCIWA 2013) and the Shopping Centre Council of Australia reported that all members had 'very positive' customer feedback in relation to Sunday trading in its first year, and 75–90 per cent participation by specialty stores (sub. DR27). One member reported sales growth of 6 per cent, of which 80 per cent was attributed to Sunday trading (sub. DR27). In South Australia, adding nine trading days in

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Adelaide's central business district in 2012 through opening on public holidays substantially increased net retail turnover, according to Business SA (sub. DR24).

Although the impacts of changes to shopping patterns are generally too 'granular' to discern in aggregate retail data given the effects of broader macroeconomic factors, Ernst & Young found that removing restrictions on Easter Sunday trading in Victoria in April 2011 increased retail turnover in that state in that month (ANRA 2014).

The argument that retail expenditure is somehow fixed is not borne out by the evidence. Over the past decade, in real terms, consumption per person of consumer goods increased in each jurisdiction, and by around a third overall. This is despite the trend to increased household saving (chapter 2) and the decline in retail expenditure as a share of overall household consumption expenditure.

One source of retail spending is tourists. Jurisdictions that cater to the expectations of overseas visitors in particular are well placed to capture the economic benefits of tourism spending. In Australia, retail spending by international tourists generates almost 10 per cent of tourism exports, with international visitors spending more than \$2.7 billion in the year to March 2014 (Austrade, sub. DR34). While some jurisdictions have attempted to cater for the expectations of tourists through less restrictive trading arrangements in some areas, these may not be sufficient to satisfy the expectations of international visitors. According to Austrade, visitors spend only a short time in a location and are likely to seek to engage in retail and associated activities at times that may be considered 'after hours' when retailers do not have the opportunity to open because of trading hours restrictions (sub. DR34).

Removing trading hours restrictions could have a compounding effect where it leads to spending on other activities. After the introduction of Sunday trading in Perth, all Shopping Centre Council of Australia members sought earlier opening (from the current 11 am opening) for their major tenants as it would provide benefits to food and beverage retailers such as cafes (sub. DR27). In a similar vein, Austrade noted that trading restrictions discourage spending on other entertainment activities and investment in entertainment and leisure precincts (sub. DR34).

At the firm level, removing trading restrictions increases the scope for businesses to achieve scale economies and reduces red tape costs where it alleviates requirements to comply with trading restrictions, particularly for businesses operating nationwide or across jurisdictions with highly localised rules. For national retailers, these requirements can involve at least 16 additional tasks required from 11 different classifications of employees to prepare stores to open on a public holiday, arising from changes to staff rosters, deliveries, and cleaning, waste and cash collection services (ANRA, sub. 16). To avoid these costs, and trade on restricted trading days, firms face often expensive exemption processes that do not necessarily provide timely or successful outcomes (see below).

For consumers, deregulated trading hours, particularly Sunday trading, means they can shop according to their preferences as determined by their work, leisure and family

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commitments. Comparisons of shopping habits between restricted and unrestricted jurisdictions show that consumers prefer to smooth their shopping across the week.

For example, aggregate transaction data presented by the Economic Regulation Authority in Western Australia show the extent to which customer behaviour is distorted by the existing retail trading hours in that state (ERA 2014b). On weekends in particular, there is a strong demand for shopping activity immediately after shops open and another significant peak in shopping activity just before shops close (figure 5.1). Transactions in Western Australia are markedly higher on Saturdays and lower on Sundays.

This situation contrasts with the behaviour observed in the deregulated trading market of Victoria, for example, where shopping activity is more spread out and shopping precincts are less congested (figure 5.1). The distorted shopping patterns evident in Western Australia lead to more congestion and inconvenience for shoppers.

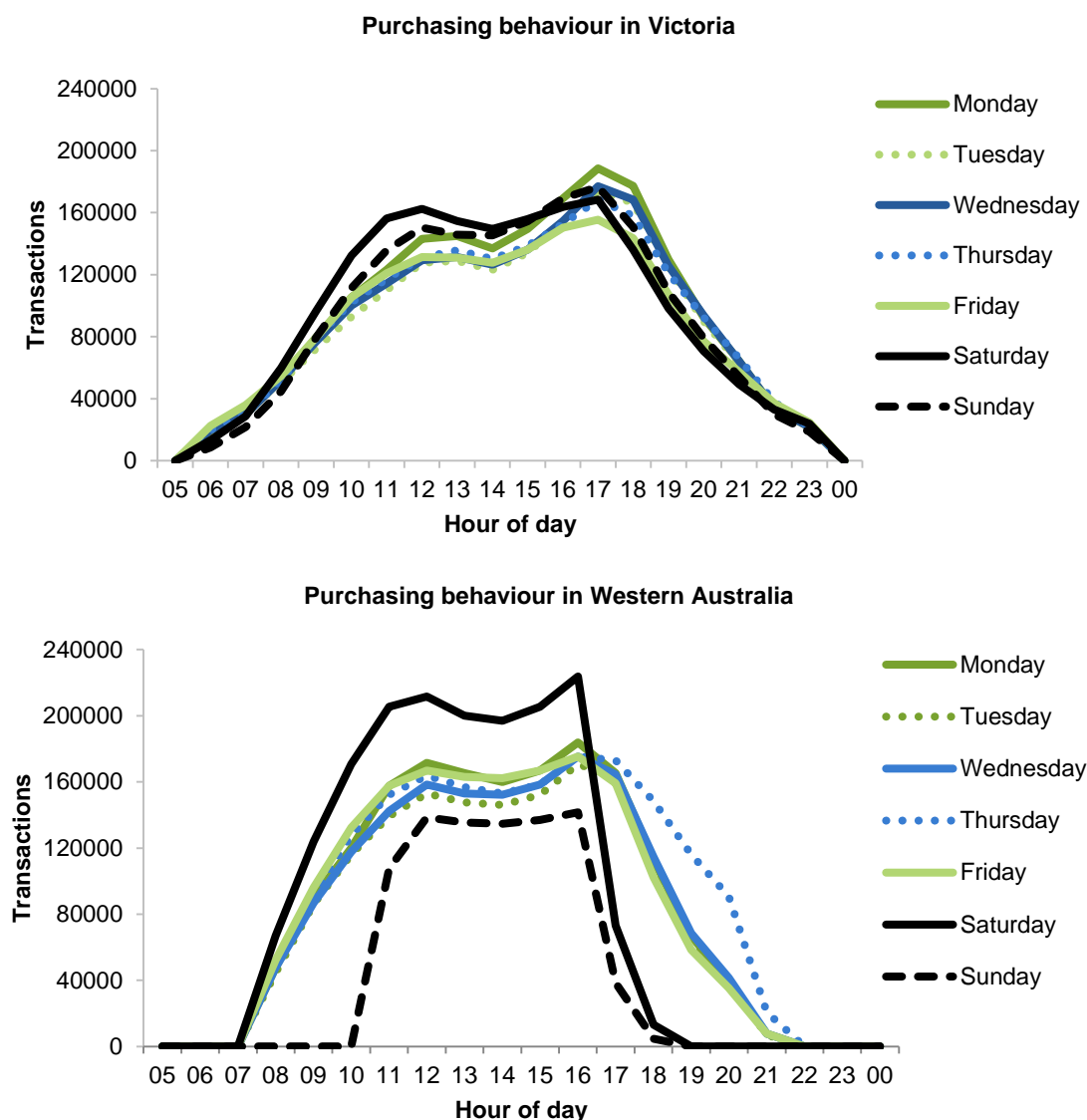
One of the key channels through which deregulation of trading hours leads to economic gains is the increased demand for labour. Longer trading hours have enabled some large retailers to substantially increase their workforce.

In Victoria, following deregulation, Coles added 2000 jobs, and Woolworths 1750 jobs, while Coles also added 450 jobs in Brisbane in 2002 when trading hours were extended, and 280 jobs in Tasmania following deregulation in 2002 (ANRA 2014).

In Perth, the introduction of Sunday trading in 2012 has created additional employment across supermarkets and other large retail outlets — for large grocery retailers, an increase of more than 1000 employees (CCIWA 2013) while the 700 jobs added by Woolworths include those in discount department and home improvement stores as well as in supermarkets (box 5.1).

A 2014 retail workforce study found that a large proportion of employees are part-time or casual, and retail employment is overwhelmingly drawn from the youngest age cohort compared to the all-industries average (AWPA and SSA 2014). While the proportion of workers aged 45 and over is less than the all-industries average, employment among this age group increased by around 16 per cent between 2005 and 2011. Within this age group part-time employment is concentrated among those aged 65 and over (AWPA and SSA 2014). The sector also provides low entry barriers in terms of qualifications for first-time job seekers (AWPA and SSA 2014). Increased retail trading hours could provide employment opportunities for all of these groups.

Figure 5.1 **Purchasing behaviour in Western Australia affected by restricted trading hours on Sunday<sup>a</sup>**



<sup>a</sup> Aggregate transactions in Coles stores (10 in Victoria, 10 in Western Australia) over a 12 month period in 2012 and 2013.

Source: Adapted from (ERA 2014b).

As discussed below, while Master Grocers Australia / Liquor Retailers Australia argued that there would be a loss of employment because of a decline in the number of smaller businesses (sub. DR26), Australian Bureau of Statistics data show no apparent relationship between trading hours regulation and the proportion of small businesses (figure 5.4).

Overall, retail is a significant employer in all jurisdictions regardless of whether trading restrictions apply. The retail sector is currently the largest employer in Western Australia (11.1 per cent) and the second-largest employer in New South Wales (10.6 per cent),

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Victoria (11.2 per cent), Queensland (10.7 per cent), South Australia (11 per cent) and Tasmania (11 per cent) (ABS 2014g).

**FINDING 5.1**

Trading hours restrictions arose in response to cultural and social expectations that are decades, and in some cases centuries, old. They are increasingly out of step with changing patterns of work, leisure and shopping as shown by the widespread take-up of extended shopping hours, and technological developments that allow consumers to shop online 24 hours a day, seven days a week.

**FINDING 5.2**

The deregulation of trading hours is expected to increase economic activity and lower retailers' cost of doing business. It would also increase choice and convenience for consumers. Further, it could enhance employment opportunities particularly for younger and older workers and those working part-time or on a casual basis.

## **Anomalies and distortions**

Jurisdictions' piecemeal approach to deregulation has reinforced the patchwork of regulations across and within jurisdictions with consequential distortions and anomalies. While there has been an extension in permissible hours of operation for bricks and mortar retailers in some locations (in particular in city areas), this has increased the variability of location-specific arrangements around the country and sharpened the comparative disadvantage of those retailers and consumers outside the areas where trading hours have been extended.

Jurisdictions to varying degrees restrict trading hours by hour of the day, day of the week, whether it is a public holiday, the geographic location of the shop, its physical size, the number of owners and/or employees and product lines sold. This leads to highly localised and firm-specific trading arrangements within and across jurisdictions, thus increasing complexity and compliance costs for businesses.

In Queensland, there are more than 30 trading zones with prescribed rules on which businesses can trade and when. This can result in highly-localised variations in trading hours in relatively small geographic areas. In Brisbane, there is a wide array of different trading hours configurations for the 'Inner City of Brisbane' and for specific parts of the Inner City, being 'Area of City Heart of Inner City of Brisbane' and 'Area of New Farm of Inner City of Brisbane' (QIRC 2014). The Commission has also identified one trading zone in Queensland (Cooloola Cove) that appears to only contain one supermarket and specific trading hours are applied to it.

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In South Australia, Sunday trading hours vary by shop location, size and product range. Stores located outside prescribed zones in Adelaide and regional areas, and/or small shops or shops selling certain goods (for example, chemists and nurseries) can trade over unrestricted hours. However, larger stores located in the greater Adelaide shopping district that are not exempt by product line can only trade between 11 am and 5 pm on Sundays while larger stores located outside Adelaide in prescribed shopping districts cannot trade at all on Sundays. On public holidays, some shops in Adelaide's central business district can open, but shops in the nearby metropolitan area cannot.

In Western Australia, different degrees of restrictions apply across the state without any obvious coherent policy rationale. Retail trading hours are deregulated north of the 26<sup>th</sup> parallel of south latitude for historical reasons. However, those areas that are regulated have highly localised variations (figure 5.2). In the Perth metropolitan area, general retail shops have been able to open on Sundays between 11 am and 5 pm since 2012, but cannot trade in regional areas on Sundays unless location-specific exemptions apply. In some cases, these location-specific exemptions have meant more restrictive trading hours, with general retail shops in three local government areas maintaining the previously regulated closing time of 1 pm on Saturdays (shown as 'heavy' restrictions, in figure 5.2). In other cases, while trading restrictions have been relaxed in some areas, this only applies to some towns in the local government area, or even specific streets or shopping centres.

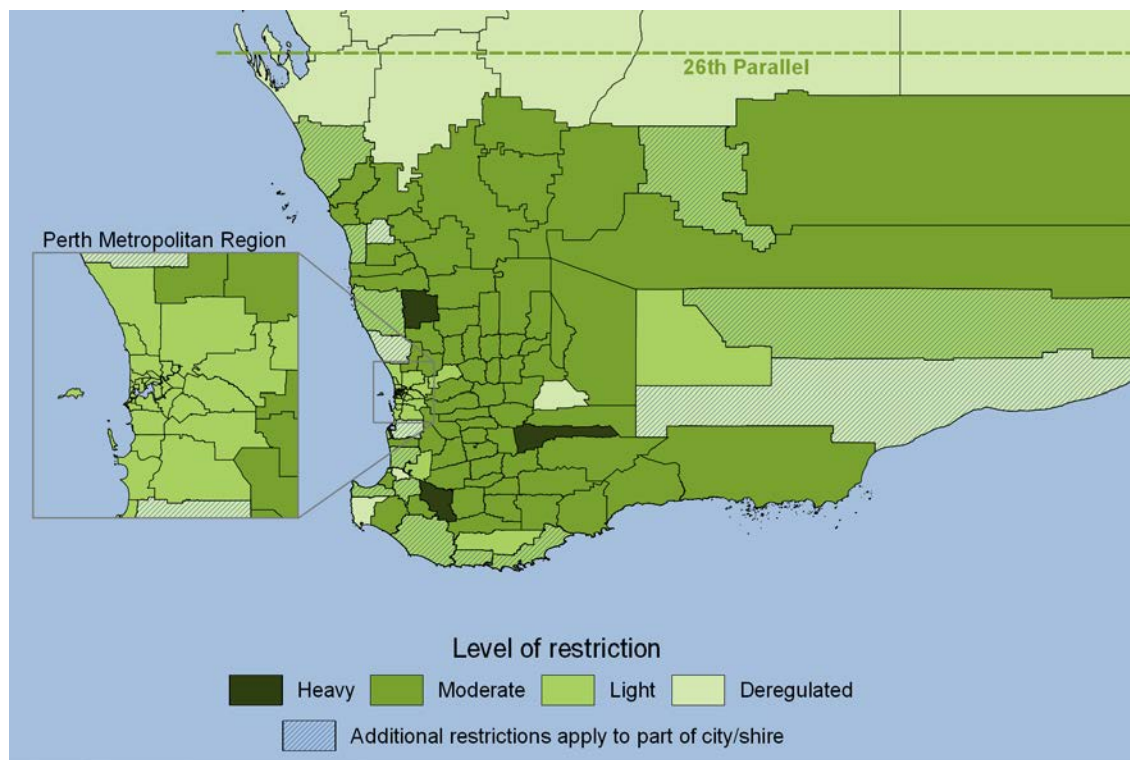
Of the 29 jurisdictions in Western Australia that have taken the opportunity to modify their retail trading hours, all have extended their hours and eight have fully deregulated their trading hours (ERA 2014b). No local government authority has subsequently sought to re-regulate their trading hours in the past 15 years (ERA 2014b).

An example of the complexities involved in complying with trading hours restrictions is illustrated in figure 5.3.

On Easter Monday, for example, shops can open without restriction in New South Wales, Victoria, Tasmania, the ACT and the Northern Territory and north of the 26<sup>th</sup> parallel in Western Australia. In other jurisdictions there are a number of special arrangements based on product line, type and size of shop and location. For example, in South Australia, larger retailers in Adelaide can open in the central business district between 11 am and 5 pm but cannot open in the metropolitan area. In Western Australia, shops in the Perth metropolitan area, smaller shops and those selling prescribed goods may trade (although the trading hours vary), while in Queensland smaller shops and certain categories of shops, and shops in specified locations are permitted to trade on Easter Monday.



**Figure 5.2 Retail trading hours regulations in Western Australia, 2014**  
Local variations<sup>a</sup>



<sup>a</sup> Based on latest ABS boundaries data (2011).

Sources: ABS (Cat. no. 1259.0.30.001, 2011); Department of Commerce (WA) (nd; pers. comm., 18 July 2014).

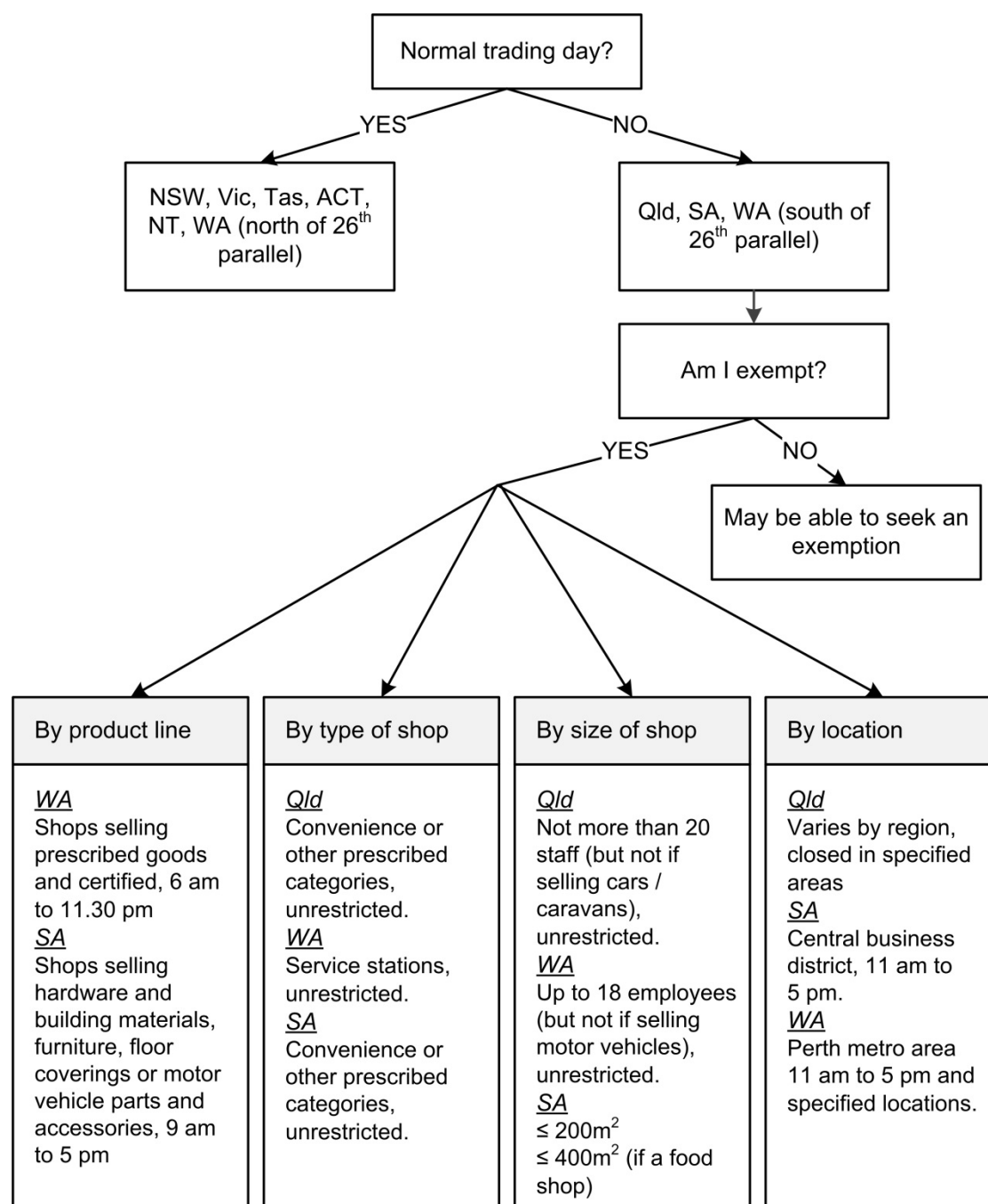
Arbitrary restrictions on product lines, including rules on what products can be sold at particular times, impose additional costs on retailers of all sizes from lost revenue and diverting resources to ensure compliance. In many cases, these rules are anachronistic and have no apparent rationale (box 5.2).

New South Wales, Queensland, South Australia and Western Australia provide avenues for retailers to seek exemptions.

In New South Wales, applicants are required to demonstrate that there are exceptional circumstances and the exemption is in the public interest. This process is considered the most stringent of exemption processes across all jurisdictions and can potentially cost a business thousands of dollars (ANRA 2014). In Queensland, the application process has been described as expensive and adversarial (Woolworths, sub. 13). In Western Australia, local governments in non-metropolitan areas can amend their trading hours where approved by the Western Australian Minister for Commerce. The WA Local Government Association acknowledged that these approval processes may not be subject to an

appropriate framework to balance competing interests within their local communities (pers. comm., 29 August 2014).

Figure 5.3 Retail trading hours regulation — Easter Monday<sup>a</sup>



<sup>a</sup> Some restrictions (for example ownership) not shown.

Sources: Business Victoria (nd); Department of Commerce (WA) (nd); ERA (2014b); NSW Government - Industrial Relations (2013); NRA (2014); SafeWork SA (nd).

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## Box 5.2      **Participants' views on trading hours boundaries and anomalies**

Regulation of trading hours, particularly restrictive trading days on public holidays, is inconsistent across State jurisdictions, causing added complexity and cost and lost income for retailers. ... For each of these trading times, there may be an additional layer of restriction on the:

- Maximum number of employees staffed at any one time,
- Floor size of the shop, and
- Type of goods sold.

... in addition ... there are also restrictions within States/Territories on when retailers are permitted to trade ... in some States/Territories trading hours are regulated by multiple legislative instruments. For example, in New South Wales retailers must comply with the trading restrictions prescribed in both the Liquor Act 2007 and the Shop Trading Act 2008. (Coles, sub. 7, p. 5)

Thirty six different zones define which business can trade during certain times and confusion around trading category, location, product type, activities, ownership structures, and number of employees, makes Queensland the most restrictive trading hour's framework in the country. (Chamber of Commerce and Industry Queensland, sub. DR29, p. 6)

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

- Allows the sale of light bulbs but prohibits the sale of light fittings
  - Allows the sale of outdoor lighting but prohibits the sale of indoor lighting
  - Allows the sale of kitchen sinks but prohibits the sale of dishwashers
  - Allows the sale of wood-fire heaters but prohibits the sale of gas heaters
  - Allows the sale of indoor television antennae but prohibits the sale of outdoor television aerials.
- (Woolworths, sub. 13, p. 2)

The Chamber of Commerce and Industry in Queensland advised that anomalies in Queensland's trading hours disadvantaged small businesses — for example, where hardware stores could sell ride-on mowers on Sundays yet motor vehicle dealerships could not (sub. DR29). In Western Australia, product line restrictions prevent Masters from trading as a 'domestic development shop' (and accessing extended trading hours) as it stocks both light bulbs and light fittings (Woolworths, sub. 13). These restrictions have prevented Masters stores opening at times convenient to tradespeople, with up to 50 people waiting in car parks for stores to open (ERA 2014a).

Boundaries also increase inconvenience and costs for shoppers travelling to areas that provide the amenity that suits their preferences.

For example, in New South Wales, Woolworths' Shellharbour store is exempt from trading hour restrictions on Boxing Day but other stores (for example, in Wollongong, around 20 kilometres away) are closed. On Boxing Day, the proportion of Woolworths' Shellharbour store revenue from residents outside the store 'catchment' rises to 40 per cent compared with 20 per cent on a 'typical' trading day (Woolworths 2014). At least part of this increase is likely to be attributable to Wollongong store customers shopping in

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Shellharbour on Boxing Day, as they continue to shop on restricted trading days but just have to drive further to get to open shops.

In South Australia, while public holiday trading in Adelaide's central business district has increased consumer choice, Business SA considered there could be significant additional gains for consumers if the geographic footprint for public holiday trading was expanded to enable consumers to shop in their preferred location (sub. DR24).

#### FINDING 5.3

The arbitrary boundaries and exemptions which are a feature of retail trading hours particularly in Queensland, Western Australia and South Australia lead to unintended consequences and anomalies which can disadvantage businesses of all sizes. For example, artificial restrictions on product lines, which in many cases are anachronistic and have no apparent rationale, can impose additional costs on retailers from lost revenue and the diversion of resources to compliance.

## Other issues

According to some participants in this study, the objectives of trading hours restrictions include promoting competition by protecting small businesses, particularly in the grocery sector, and reducing the need to work outside 'traditional' working hours (box 5.3).

### Protecting small business

Master Grocers Australia / Liquor Retailers Australia and the Chamber of Commerce and Industry Queensland opposed the further deregulation of trading hours and claimed that it would affect smaller retailers (sub. DR26 and sub. DR29). Dr Margetts noted trading hours deregulation had attracted long standing criticism from small or independent grocery retailers concerning the market power of larger retailers (sub. 1).

However, in many cases shoppers are substituting to other large stores or shopping online. Shoppers are prepared to travel some distance to shop at larger retailers (for example, the experience of shoppers travelling to Shellharbour as previously discussed). While consumers once would have shopped at smaller retailers in response to larger store closures, online shopping now provides additional choice, convenience and price-competitive options for consumers. In general, there are no trading hours restrictions for online shopping. While currently there can be a price premium for the convenience of online grocery shopping, this cost disadvantage can be expected to dissipate with the development of more flexible and efficient formats, such as 'dark warehouses' dedicated to online sales.

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### Box 5.3 Participants' views on trading hours – other issues

Some participants in this study were concerned about the impact of relaxing restrictions on trading hours on the survival of small businesses:

The Queensland Government is generally satisfied with the current arrangements for trading hours regulation in Queensland and has consistently expressed the concern that small business is not adversely affected by any reform. (Queensland Government, sub. DR37, p. 8)

It is the strong view of MGA/LRA that any further deregulation of trading hours in Australia will have a serious impact on the survival of small independent retailers in this country ... The biggest threat to the community however, if the smaller retailers are gradually pushed out of the market, is the fact that there will not be any competition ... (Master Grocers Australia / Liquor Retailers Australia, sub. DR26, pp. 3, 9)

The SDA was also concerned about pressure for smaller businesses to open on public holidays:

... what also must be taken into account is the need for balance between the needs of major retailers and the needs of employees and small business operators. The latter groups do need time away from work for family and leisure purposes.

For employees this means the opportunity for "voluntary work" on public holidays and Sundays', and for retailers, the right not to be forced by major shopping centre managements to open on public holidays as a condition of the maintenance of their lease. (sub. 6, attachment 1, p. 5)

The Shopping Centre Council of Australia noted that shopping centres are not forced to open on Sundays and public holidays, but that when shops don't open it can affect retail activity:

Retail tenancy legislation and/or trading hours legislation means retailers cannot be forced to trade on these days so shopping centre owners and managers run the risk of an increasing number of shops being closed on these days. This becomes a vicious circle for the shopping centre since closed shops are a turn off to shoppers who may then be reluctant to visit the centre again on these days. (sub. 17, p. 19)

Overall, the evidence does not support the claim that deregulation of trading hours has a material impact on the structure of the retail sector and the viability of small retailers. There is no obvious relationship between the proportion of small businesses in a jurisdiction and its approach to trading hours restrictions — the proportion of small businesses has increased in jurisdictions with regulated and deregulated trading hours since the Commission's 2011 inquiry (figure 5.4).

Participants put forward diverse views on the link between online retailing and trading hours. The SDA said there was no evidence of such a link (sub. 6). On the other hand, Business SA and the Chamber of Commerce and Industry Queensland suggested that restricted trading hours placed bricks and mortar retailers at a competitive disadvantage (sub. DR24 and sub. DR29).

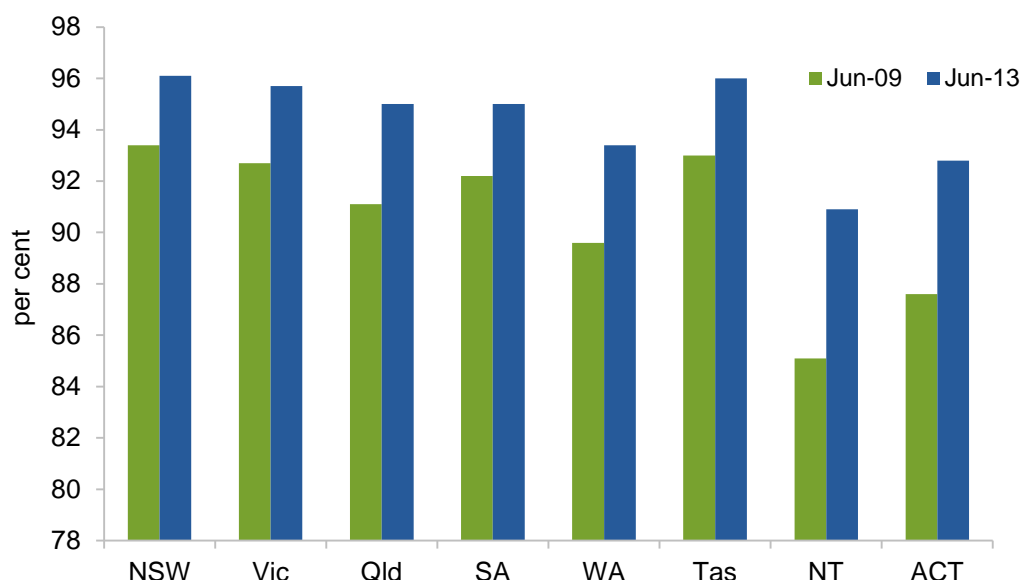
Surveys and internet traffic data suggest that convenience and price are strong motivators for consumers to shop online (chapter 2). A 2013 Choice survey found that the main reason Australians shop online is so they can shop when it suits them (Choice 2013), while data show a correlation between online shopping patterns and movements in the exchange rate (Google 2014). With a growing proportion of internet users purchasing durable, discretionary and staple household goods online (chapter 2), to the extent that trading hours

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restrict consumer choice as to when to shop, this reduces the competitive advantage of bricks and mortar retailers.

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**Figure 5.4 Proportion of small businesses in the retail sector**



Sources: ABS (Cat. no. 8165.0, 2014; Cat. no. 8165.0, 2011).

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In contrast to most regulatory settings, such as trade practices regulations, the narrower scope and objectives of trading hours restrictions do not seek to balance broader consumer and community interests. By using the participation of small businesses in the market as a metric for competition, these restrictions ignore the potential for more than offsetting gains in terms of the lower cost of doing business and increased consumer welfare in such an economically significant sector.

### Protecting retail workers

Despite concerns that retail trading regulations are needed to protect retail workers' leisure time, the Commission's 2011 inquiry found no evidence that extended shopping hours adversely affect participation in leisure activities in Australia (PC 2011a). In any case, current trading hours arrangements may not effectively provide such protection. For example, in South Australia, trading restrictions would offer the most protection to around a third of retail employees who are employed in shops that are heavily regulated. The majority of retail employees either work in shops that are completely deregulated (56 per cent) or partly regulated (10 per cent) (Business SA, sub. DR24).

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A further concern expressed by participants was that deregulation would create extremes in trading (for example, 24 hour bricks and mortar trading) to the detriment of retail sector workers. The experience in jurisdictions with unrestricted trading hours is that deregulation enables retailers to open according to consumer demand and this does not lead to 24 hour a day, seven days a week bricks and mortar trading (ANRA 2014).

## 5.4 Impediments to reform

Jurisdictions have chosen to take an incremental approach to deregulating trading hours, despite numerous recent reviews supporting effectively full deregulation (Commission's 2011 retail inquiry (PC 2011a), two reviews into Western Australia's trading hours (Atkins 2011 and ERA 2014b), and the Queensland Competition Authority's report on reducing regulatory burdens (Queensland Competition Authority 2013)).

This 'creeping' deregulation, which in part appears to be in response to issues arising from existing boundaries and anomalies, inevitably creates new 'lines in the sand' that further distort decisions by consumers and retailers. In the case of Queensland and Western Australia, their patchwork of regulation has created many lines in the sand.

However, reform seems unlikely to be achieved without the commitment of governments in individual jurisdictions. Participants expressed concerns with the slow pace of reform, with the Australian National Retailers Association and the Shopping Centre Council of Australia seeking greater involvement by the Australian Government, including through the Council of Australian Governments.

The slow progress of trading hours deregulation demonstrates the need for political commitment in achieving sound regulatory outcomes — an issue highlighted by the Commission's submission to the Australian Government's competition policy review (PC 2014c). The OECD has found political commitment to regulatory reform to be one of the main factors supporting regulatory quality (OECD 2010).

### FINDING 5.4

Despite the partial changes since 2011 in South Australia and Western Australia, retail trading hours restrictions continue to impose costs on retailers and reduce consumer welfare. There is evidence of the benefits of reform from state regulatory review agencies. The main impediment to deregulation appears to be a lack of political commitment, a significant driver of regulatory policy reform.





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## 6 Planning, zoning and retail tenancy leases

### Key points

- Planning and zoning systems establish how land can be used and how such uses can be changed. In terms of retail trade, the planning policies of state and territory governments are typically formulated around ‘activity centres’ which seek to deliver net benefits to the community by concentrating retail and other employment activities into specified locations.
  - However, land use regulation that centralises retail activity can be either competition-enhancing or competition-reducing, depending on how it is designed and implemented by the relevant planning authorities.
- Most state and territory governments have conducted major reviews of their planning and zoning systems in recent years or are in the process of completing reviews. Progress in implementing leading practices has, however, been slow and patchy. Victoria is generally considered to be ahead of other jurisdictions in implementing leading practices for planning and zoning.
- Important reforms to planning and zoning systems that are essential to the development of competitive markets for retail space include:
  - broadening and simplifying business zoning to remove the need for ad hoc changes to council plans to accommodate each variation in business model
  - removing consideration of the commercial impact on existing business when assessing development applications.
- Inadequate resourcing (particularly in relation to suitably skilled and trained staff) at the local government level can compromise the achievement of planning and zoning outcomes, and make it more difficult for local governments to implement state and territory government policies and regulations consistently and as intended.
- Retail tenancy issues remain a concern to many stakeholders, particularly smaller retailers operating in shopping centres. Wider implementation of the leading practices identified by the Commission in its 2008 study of retail tenancy markets should help to resolve some of these problems.
- However, the Commission considers that the root cause of many problems in the retail tenancy market is restrictive planning and zoning legislation that unnecessarily limits competition and restricts retail space, particularly in relation to the supply of retail space in shopping centres. Addressing this issue should help to resolve problems in the market for retail tenancy leases.

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## 6.1 Introduction

As highlighted in chapter 3, a significant cost component in the retail sector is the cost of occupancy, particularly the cost of renting or owning retail space. This cost is largely determined through the interaction of buyers and sellers in the market for retail space. However, the planning and zoning policies of state, territory and local governments, as well as their laws governing retail tenancy agreements, influence the supply side of this market. Hence, these policies cannot be ignored as potential drivers of retail sector occupancy costs.

## 6.2 Planning and zoning

Planning and zoning systems establish how land can be used and how such uses can be changed. In terms of retail trade, the planning policies of state and territory governments are typically formulated around ‘activity centres’ which seek to deliver benefits to the community by concentrating retail and other employment activities into specified locations.

If planning and zoning systems work reasonably well, the market for retail space should be comparatively efficient, with retail space generally allocated to its highest valued uses. However, if planning and zoning systems are too restrictive, or impose unnecessarily high compliance costs on property owners and developers, then the supply of retail space will generally be too low and the cost of occupancy will be unnecessarily high.

Issues of retail space affordability can affect both the level and type of retail business activity in a region. An increase in business costs not only limits the viability of investment for incumbent firms but also adversely affects the entry of new firms in a market.

Ultimately, inflexible and inefficient planning and zoning systems penalise consumers because they restrict choice and convenience, and generally make retail goods less affordable than they would be otherwise.

### Reforming planning and zoning regulations

In its examination of the economic performance of the retail sector in 2011, the Commission observed that land use regulation that centralises retail activity can be either competition-enhancing or competition-reducing, depending on how it is designed and implemented by the relevant planning authorities.

To minimise the anticompetitive effects of zoning, policy makers need to ensure that areas where retailers locate are both sufficiently *large* (in terms of total retail floor space) and sufficiently *broad* (in terms of allowable uses, particularly those relating to business

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definitions and/or processes) to allow new and innovative firms to enter local markets and existing firms to expand (PC 2011a).

In light of this, the Commission considers that two planning and zoning reforms are of particular importance to the efficiency and competitiveness of the retail sector:

- governments should broaden and simplify business zoning to remove the need for ad hoc changes to council plans to accommodate each variation in business model
- governments should not consider the viability of existing businesses at any stage of planning, rezoning or development assessment. Impacts of possible future retail locations on existing activity centre viability (but not specific businesses) should only be considered during strategic plan preparation or major review.

Other reforms to planning and zoning that could improve competition in the retail sector include:

- facilitation of more ‘as-of-right’<sup>23</sup> development processes
- clear guidelines on alternative assessment paths
- disincentives for gaming of third party appeals (PC 2011b).

Improving development assessment processes was also a key consideration of the Development Assessment Forum (DAF), an independent advisory forum of government, industry and planning professions. The DAF was created in 1998 to focus on developing initiatives to reduce the length and complexity of development assessment processes.

In 2005, the DAF produced a ‘Leading Practice Model for Development Assessment’ which sets out 10 leading practices for jurisdictions to adopt with a view to a simpler, more effective approach to development assessment. It was endorsed by state and territory planning ministers in 2005 through the Local Government and Planning Ministers’ Council (LGPMC). Although the LGPMC — which brought together local government and planning ministers from the Australian, state and territory governments, together with the President of the Australian Local Government Association — was disbanded in 2011, the DAF continues to pursue the case for greater coordination and cooperation between state and local government planning departments, industry, and the Australian government, to better facilitate the implementation of the leading practices model across jurisdictions.<sup>24</sup>

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<sup>23</sup> ‘As-of-right’ developments are those that comply with all applicable zoning regulations and do not require any discretionary action (such as a consideration of economic, environmental or social impacts) by the assessment body in order to be approved.

<sup>24</sup> For more information see PC (2011b, p. 79). The DAF’s ‘Leading Practice Model for Development Assessment’ is available here: <http://www.planning.org.au/policy/development-assessment-forum>.

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## Competitive pressure arising from growth in international online shopping

Part of the cost of unnecessarily restrictive planning and zoning systems is ultimately passed on to Australian consumers in the form of higher prices for retail goods. However, where Australian retailers face growing competition from international online traders, the former may find it more difficult to continue to pass on any extra costs arising from inefficient planning and zoning systems to Australian consumers. This could compromise the long term profitability and viability of some Australian retailers, and further justifies action to address any deficiencies in planning and zoning systems as quickly as possible.

## Substantial net benefits could be achieved from reforming planning and zoning

The net benefits to the nation from reforming planning and zoning systems could be substantial. For example, in a previous report the Commission estimated that implementing just two reforms to development assessment processes that apply to commercial and industrial sector development applications (which includes applications relating to retail space) — greater use of electronic processing and increased use of code-based assessment — could generate net cost savings to the nation of around \$240 million per year (PC 2012b). The cost savings are in the form of lower compliance costs and shorter approval times, and reduced government spending.

In New South Wales, a recent study commissioned by the state government into the potential benefits from comprehensively reforming planning and zoning in that state showed net benefits ranging between \$569 million and \$1482 million per year, depending on the reform option considered (The CIE 2013).

## Progress since 2011

As indicated earlier, planning and zoning is primarily the responsibility of state, territory and local governments. This section summarises the extent to which the state and territory governments have implemented changes to their planning and zoning reforms, particularly in relation to recommendations made by the Commission in its 2011 inquiry.

### Reviews conducted or underway, but less progress in implementation

Some jurisdictions have conducted major reviews of their planning and zoning systems in recent years, or are in the process of completing reviews. Progress in implementing leading practices has, however, been slow and patchy. As noted by the Large Format Retail Association (LFRA):

There has been a trend towards review of planning regulation however the only review to date that has resulted in positive changes is in Victoria. (sub. 19, p. 9)

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Nevertheless, most state and territory governments have made progress since 2011 in implementing some of the leading practices in planning and zoning recommended by the Commission and others. This is particularly the case in relation to the adoption of risk or track-based development assessment processes. Under this approach, development and rezoning applications are streamed into assessment ‘tracks’ (exempt, prohibited, self assess, code assess, merit assess and impact assess) that correspond with the level of assessment required to make an appropriately informed decision. This both speeds up most development assessments and rezoning decisions, and releases assessment resources to focus on those proposals that are particularly technically complex or difficult.

Jurisdictions have also made progress in relation to increasing the transparency and reducing the complexity of their planning and zoning systems, and in developing or improving electronic systems for lodging and tracking development applications. The latter offer potential benefits to retailers and governments in the form of time and other cost savings when processing development applications.

Online systems also have the potential to provide valuable data and information that could be used to better assess the transparency and efficacy of both state and local government planning processes, and (at times) Australian Government policies and decisions that have a planning dimension. The latter include the *Environment Protection and Biodiversity Conservation Act 1999* (Cwlth), and decisions relating to the development of Commonwealth lands and airports (Australian Local Government Association, pers. comm., 18 July 2014).

### *Victoria*

Victoria is more advanced in adopting planning and zoning reforms than other jurisdictions (box 6.1). A simplification of Victoria’s business zones in 2013 has the potential to open up the market for retail space, increasing the supply of land for retail development and use. The Victorian Government is also planning improvements to the development assessment process that should reduce development assessment compliance costs, particularly with respect to waiting times. As noted by the LFRA:

These changes are entirely consistent with the recommendations of the Productivity Commission and should serve as a model for other States and Territories to follow. (sub. 19, p. 13)

On the other hand, Victoria retains strong third party appeal rights, and this was identified as a potential weakness by the Commission in its 2011 inquiry report, particularly as it could lead to excessive gaming of planning decisions.<sup>25</sup>

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<sup>25</sup> For more information on gaming of planning and zoning systems see PC (2011a) and PC (2011b).

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### Box 6.1      **Recent planning and zoning reforms in Victoria**

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

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

The introduction in September 2014 of VicSmart — a new development permit process — is expected to significantly speed up the time taken to assess low-impact development applications in Victoria. A key element of this process is reducing the waiting time on permit applications from 40 days to 10 days for eligible applications. (In contrast, one application for a sign by a business in South Australia took 18 months for a decision — by which time the business had closed down.)

The threshold value for VicSmart eligibility are developments costing less than \$50 000, and will cover applications for some subdivisions as well as minor buildings and works such as fences, signs and small alterations and additions to shops, offices and factories. Streamlined processes will also be introduced at the Victorian Civil and Administrative Tribunal to reduce the time and other cost burdens associated with decision appeals.

The recent announcement by the Victorian Government of Plan Melbourne — a strategy document for the future development of the City of Melbourne — proposes greater use of higher density mixed-use zones (particularly in the city centre, but also in precincts around railway stations and other transport corridors where there is greater potential for such developments), along with a proposal to remove retail floor space and office caps in activity centres. These developments are consistent with moving to a less prescriptive approach to planning and zoning.

The Victorian Government also plans to enshrine an ‘agent of change’ principle in the state’s planning framework. Under this approach, for example, the owners of a new residential development that is built near existing live music venues would be responsible for noise mitigation measures (at the venue or at the residential development) as part of the planning process. Correspondingly, in the case of a new entertainment venue proposed near existing residences, the venue owners (as the agent of change in this case) would be responsible for noise mitigation.

*Sources:* Victorian Government (2014); South Australian Government (2013).

### *New South Wales*

Stakeholder criticism of the current system of planning and zoning in New South Wales has been comparatively strong. In a submission to this study the Australian National Retail Association (sub. 16, p. 8) labelled the planning system in New South Wales as one of the more ‘dysfunctional’ in Australia, while the LFRA (sub. 19, p. 11) described it as ‘outdated’, ‘overly complex’, ‘time consuming’, and ‘in need of a complete overhaul’.

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The New South Wales Government has completed a major review (White Paper) of its planning and zoning system, including commissioning an external evaluation of the likely benefits flowing from reforms (New South Wales Government 2013). The reform options canvassed in the review align with the leading practices recommended by the Commission and the DAF, and could materially improve planning and zoning outcomes in New South Wales if implemented.

However, the draft legislation that is currently before the New South Wales Parliament is less ambitious compared with the changes considered in the White Paper. One major retailer noted that:

While the principles and directions contained in the White Paper were strongly supported by ALDI and many other stakeholders, the legislation ultimately introduced into parliament by the NSW Government was so weakened and compromised as to represent very little improvement on the current system. (ALDI 2014, p. 7)

At the time of writing, the Planning Reform Bill 2014 remains on the agenda for consideration by the New South Wales Legislative Assembly.

On the positive side, the New South Wales Government has made some changes to the *State Environmental Planning Policy (Exempt and Complying Development) 2008* that reduce business red tape by increasing the categories of development that are eligible for streamlined approval. There are now approximately 80 categories of exempt development. This aligns with the Commission's 2011 recommendation to facilitate more 'as-of-right' development. The state government also recently announced the rollout of an 'e-planning' initiative for lodging and tracking development applications online. The new system is expected to be fully operational by the end of 2015.<sup>26</sup>

### *Queensland*

The Queensland Government is in the process of reforming planning legislation, including reforming the state's planning and development assessment system. According to the LFRA:

The proposed changes to the Queensland planning system are also based on principles consistent with the Productivity Commission recommendations. The LFRA is encouraged by the recent progress and direction of planning reform in Queensland. (sub. 19, p. 12)

Grocery retailer ALDI recently described the planning and zoning system in Queensland as better than that of the other eastern states, but nevertheless with 'significant room for improvement' (ALDI 2014, p. 5).

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<sup>26</sup> More information on the e-planning initiative is available from the New South Wales Government website: <http://www.planning.nsw.gov.au/en-au/buildinginnswe-planningfornew.aspx>

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## Western Australia

The Western Australian Government is also in the process of reviewing and reforming its planning system. Reforms being considered under ‘phase 2’ of the program include some that are consistent with leading practices, such as greater use of a track-based development assessment model, and greater use of electronic systems for development applications. However in relation to the issue of simplifying business zones and broadening permissible uses within zones, the reforms being considered appear to be comparatively modest.

There are no third party rights of appeal against planning decisions in Western Australia. Third parties are, however, given several opportunities to make submissions on various types of planning instruments, including for subdivision and development applications in specific circumstances. According to the Western Australian Government (Department of Planning, pers. comm., 11 August 2014), third party submissions are ‘... conducted under time-controlled conditions so there is no opportunity for ‘gaming’ in order to prevent competition’.<sup>27</sup>

In a submission to this study, the LFRA stated that:

In summary, there has been no substantial change in Western Australia for many years now despite the existence of various planning reviews being undertaken. The LFRA is concerned about the future of planning in the State and its ability to identify and implement changes necessary to streamline and integrate the planning system. (sub. 19, p. 16)

## South Australia

South Australia broadened business zoning in specific areas of the state in 2011, allowing greater permissibility and flexibility for a range of business activities, including retail. However, the application of the new zones and policies to the rest of the state remains incomplete. Third party appeal processes were previously assessed by the Commission as leading practice and are unchanged.

In February 2013 the State Government appointed an Expert Panel on Planning Reform to review the current planning system in South Australia. It was to consult widely with the community and all stakeholders, and make recommendations for the introduction of a new planning system for the state. The project is entitled *think-design-deliver* and the Panel is due to issue its final report at the end of December 2014. Views and opinions gathered by the Panel on the current state of the planning system in South Australia highlight significant scope for change:

Feedback from individuals, councils, practitioners and project proponents told of a confusing proliferation of plans, policies and zones, and about how these are apparently applied inconsistently across council boundaries.

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<sup>27</sup> For more information on the reform process in Western Australia, see Department of Planning Western Australia (2013).



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Issues included questions of consistency of application across 72 development plans containing 22 000 pages (including maps and planning policies) and between 600 and 1000 zones. (South Australian Government 2013, p. 55)

A related review is being conducted by the Department of Planning, Transport and Infrastructure. This review will consider whether additional flexibility and permissibility is needed within commercial and business areas, and potential grounds for out-of-centre development including how and where this might occur.

However the LFRA (sub. 19, p. 15) has questioned the appetite for reform in South Australia, and is ‘... concerned that there will be an increase in red tape as a result of the review’.

### *Tasmania*

In early 2014, the statewide planning scheme template in Tasmania reduced the number of potential planning schemes’ zones from several hundred to 23 standard statewide zones. A planning taskforce is also being assembled to consolidate the state’s planning provisions into a single statewide planning scheme.

The Tasmanian Government (Department of Treasury and Finance, pers. comm., 2 May 2014) anticipates that the Planning Reform Task Force will consider the Commission’s benchmarking report into planning and zoning (PC 2011b) when developing its reform work program.

The LFRA (sub. 19, p. 15) is of the view that Tasmania is ‘... heading in the right direction of a uniform state planning system, which is consistent ... with the Productivity Commission recommendations in 2011’.

### *Australian Capital Territory*

There has been no reduction in the number of business zones in the ACT since 2011. A recent draft variation to the *Territory Plan* (draft variation DV304) would increase the maximum shop size in some business zones, and this should enhance location options for larger shops. However, in other zones, the changes proposed under DV304 would make it more difficult for larger shops to be granted development approval.

More generally, the ACT Government’s approach to planning and zoning has been highly prescriptive until relatively recently in relation to the supermarket sector (see box 6.2). While ensuring that there is sufficient retail space available to businesses that want to compete in the supermarket sector is consistent with leading practice, specifying which retailers should be granted individual sites is not consistent with leading practice, and is unlikely to be in the best interests of the community as a whole.

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The ACT Government has announced its intention to take a less ‘interventionist’ approach to future supermarket competition policy issues (ACT Government 2014). In particular, it notes that, ‘unless a situation warrants the direct sale of a site to a particular operator, the regulation of future supermarket site acquisitions will be left to the Australian Competition and Consumer Commission’ (ACT Government 2013, p. 3).

The economic impact on other businesses remains a consideration in some circumstances under the ACT Government’s *Territory Plan*, which is inconsistent with leading practice in development assessment. However, under DV304 the remaining provision of this type would be removed.

### Box 6.2 Supermarket policy in the ACT

In 2010, concern about a lack of competition in the supermarket sector led to the ACT Government intervening in the sector to allocate land to particular supermarkets. The ACT Treasurer, Andrew Barr, recently stated:

Back more than five years ago there was certainly concern expressed about the need to introduce more competition into the supermarket business here in the ACT ... The market was dominated by the two main players so the government took a decision at that time to release more sites for new supermarkets to increase competition and meet some of the pent-up demand for additional retail space.

We sought at that time to bring in some new players so that involved Aldi and Costco being the new entrants. When Costco decided to take up the opportunity at the airport, that was a welcome addition to competition.

The ACT government also released a number of sites to facilitate a network of Aldi stores and then also made some commitments around land release that came with a precommitment for Supabarn to be the supermarket tenants in some redevelopments. The evidence shows where a full-line operator has an Aldi in close proximity, there’s much more competition and prices are more reasonable as a result.

In May 2013, Mr Barr indicated that the ACT Government will be taking ‘a new less interventionist approach to supermarket competition policy issues’ in future, noting the progress made to introduce greater competition to the sector and ‘the increased vigour of the ACCC [Australian Competition and Consumer Commission] in regulating the supermarket sector nationally’.

Sources: Peake (2014); ACT Government (2013); ACT Government (2014).

Under ACT planning legislation third party appellants are not required to identify themselves or their grounds of appeal. However, competition issues are not a legitimate ground to commence appeal proceedings, which is consistent with leading practice.

### Northern Territory

In the Northern Territory, since at least 2011, the planning authority cannot consider the viability of existing businesses in planning processes, and third party appeal processes are available in limited circumstances only. In relation to development assessments, the Northern Territory Government is reviewing the zoning tables in the Planning Scheme

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with a view to reducing the need for planning approval for ‘low risk, low impact’ uses or developments.

The Northern Territory Government has expanded and improved its online system for lodging and tracking development applications, with 100 per cent of applications now able to be lodged and monitored online. A new law (which commenced 1 May 2014) allows the concurrent assessment of rezoning and development applications in the Northern Territory, and should reduce the time and compliance costs of new retail developments (Department of Lands, Planning and the Environment, pers. comm., 19 August 2014).

The Northern Territory Government has also recently announced that the Civil and Administrative Tribunal will provide businesses (including retailers) with a one-stop-shop for access to dispute resolution facilities and a red tape business advocate as an interface between business and government (Northern Territory Government 2014).<sup>28</sup>

## **Views of stakeholders on planning and zoning**

Notwithstanding the partial progress made in planning and zoning regulations since the Commission’s 2011 study, submissions to this study and to the Australian Government’s review of competition policy indicate significant ongoing cost pressures and competition issues associated with these regulations (box 6.3).

One new entrant to the Australian retail sector described the significant additional costs it faces in establishing businesses in Australia simply because the business model it adopts is different to that of incumbent firms, and that this typically requires time-consuming and costly rezoning applications.

Another stakeholder (Kepnock Residents Action Group, subs. DR35, DR40) raised a number of concerns about planning and zoning outcomes in relation to a retail development in Queensland. Although the core issues raised in the submission are beyond the scope of this study, the submission does raise broader concerns relating to issues of transparency, consistency and accountability in local government processes and decision making, and these go to the heart of improving planning and zoning outcomes. The submission also raises important questions about noise abatement, particularly when commercial development is permitted close to pre-existing residential zones following rezoning of residential land.<sup>29</sup>

Another comparatively new entrant to the retail sector in Australia, grocery retailer ALDI, has also expressed concerns about the restrictiveness of planning and zoning systems in Australia (box 6.4).

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<sup>28</sup> More information on the Red Tape Reduction Business Advocate is available from the Northern Territory Government website: <http://www.dob.nt.gov.au/business/red-tape/Pages/red-tape-advocate.aspx>

<sup>29</sup> The regulatory response to noise abatement issues in mixed-use developments is discussed in chapter 8.

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The planning and zoning challenges faced by businesses trying to enter or expand within the Australian retail sector could limit the efficiency and competitiveness of the sector, and thereby the affordability of retail goods. A dynamic and efficient retail sector depends heavily on the periodic injection of new entrants and formats to the sector. New entrants maintain pressure on existing businesses to provide the best possible service at the lowest possible cost. While planning and zoning systems that act as an effective barrier to entry or expansion might benefit some existing retailers or owners of retail space, they are unlikely to benefit the community as a whole.

### **Box 6.3 Views of stakeholders on planning and zoning**

#### **Council of Small Business of Australia:**

There is no doubt that rent in Australia is too high and that is due to the domination of retail by a few large landlords combined with a failure to consider urban planning issues when assessing whether competition is fair and reasonable. (sub. DR20, p. 4)

#### **Swimming Pool and Spa Alliance:**

High rents and a complex leasing process are part and parcel of the major challenges faced by retailers. (sub. 5, p. 9)

#### **Business Council of Australia:**

Uncertainty, costs and delays caused by inefficient planning and zoning decisions significantly impact on competition by limiting the ability of business to enter new markets or to expand their operations in a cost-effective and timely way. (BCA 2014, p. 25)

#### **ALDI:**

More so than any other country in which it does business, ALDI has found the challenge of securing appropriate property holdings in Australia the single most significant brake on its expansion.

Since 2001, ALDI's growth has consistently been faced with the obstacle of locating and securing appropriately zoned and sized land for the development of new stores, despite strong consumer demand. It is ALDI's view that this situation is fundamentally a result of a lack of supply of correctly zoned land as well as rigidity in the current state planning systems and their administration by state and local governments. In eastern Australia, the situation is particularly poor in NSW, somewhat better in Victoria and better again in Queensland - even Queensland, however, has significant room for improvement. (ALDI 2014, p. 4)

#### **Shopping Centre Council of Australia:**

Australia's planning systems are no 'walk in the park' for our members. No retail property company or format is unique in experiencing challenges, inconsistencies, cost imposts or having their preferred outcomes thwarted as a result of Australia's planning systems; or wanting to have the lowest possible costs when acquiring land, accessing new markets or undertaking development. (sub. 17, p. 12)

#### **Independent Pricing and Regulatory Tribunal:**

We consider that there is significant scope to streamline and simplify regulatory requirements relating to land use and the development process in NSW, with beneficial effects for competition. (IPART 2014, p. 11)

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#### **Box 6.4 ALDI's planning and zoning challenges**

In a submission to the Australian Government's review of competition policy, grocery retailer ALDI has provided detailed descriptions of the difficulties it has faced in finding suitable retail spaces to roll out new stores. In some cases, the reasons given for the rejection of ALDI applications for rezoning of land include consideration by councils of the adverse consequences on existing retailers. For example:

ALDI met with Blacktown City Council's Strategic Planning Unit in February 2012 to discuss the potential for a spot rezoning of the Glendenning site. Council indicated that it does not support rezoning of the site for two reasons; Council considers that the site is not appropriate for an ALDI store on the basis that there is potential for adverse impacts to the nearby North West Growth Centre land release precincts of Schofields and Colebee and existing nearby village centres of Woodcroft Plaza and Plumpton. (ALDI 2014, p. 12)

Reference is also made to constraints on business opportunities due to the excessive prescriptiveness of zoning. For example:

ALDI owns and operates a single ALDI store within the Marrickville LGA [Local Government Area] ... ALDI has had no success in obtaining other sites in the Marrickville LGA since commencing operation in Australia in 2001 ... In February 2011, ALDI prepared a submission to the draft Marrickville LEP [Local Environmental Plan - zoning and development control document] 2011. The submission raised three pivotal concerns as follows: a lack of any proper audit of the existing business zoned land in the Marrickville LGA; an inadequate supply of land capable of supporting retail development; and the prohibition of 'retail premises' (an ALDI store) in a number of the business zones, including the 'B6 Enterprise Corridor Zone', contrary to the Metropolitan Plan for Sydney 2036 objectives for flexible land use controls. We requested that Council amend the draft LEP 2011 to increase the extent of business zones, include a 'small format supermarket' definition capped at either 1,100sqm of grocery retail sales area or 1,500sqm total floor area as well as amend the 'B6 Enterprise Corridor Zone' provisions to permit retail premises. Council did not support these suggested amendments. Council's decision means that the gazetted Marrickville LEP 2011 actually represents a reduction in suitably zoned business land and further restricts the ability to establish an ALDI store when compared to the previous LEP 2001. (ALDI 2014, pp. 12–13)

*Source:* ALDI (2014).

### **Where to next for planning and zoning reform?**

Continued action by state, territory and local governments in implementing the leading practices previously identified by the Commission and others (including the leading practices identified by the DAF) is needed to ensure that the market for retail space is competitive and least-cost, while still achieving the desired outcomes of planners in relation to amenity and other community objectives.

In its draft report, the Competition Policy Review Panel has also highlighted the need for state and territory governments to give greater consideration to competition principles in planning and zoning legislation. Key principles identified in the report include:

- a focus on the long-term interests of consumers generally (beyond purely local concerns)
- ensuring arrangements do not explicitly or implicitly favour incumbent operators

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- internal review processes that can be triggered by new entrants to a local market
  - reducing the cost, complexity and time taken to challenge existing regulations. (Competition Policy Review Panel 2014b, p. 32)

### Local governments need adequate resources to implement change

Inadequate resources and skill levels at the local government level (where state government planning and zoning policies are largely made operational) can compromise planning and zoning outcomes, and make it less likely that state and territory government policies or regulations on planning and zoning are implemented consistently and as intended.

In order to improve planning and zoning outcomes, state governments may need to consider ways to improve the capacity of local governments to implement policy changes. The ‘Mainstreet Australia’ organisation provides a forum for stakeholders (including local government planners) to exchange information and ideas on strip shopping and traditional retail centres.<sup>30</sup> Forums such as this could be part of a broader strategy to improve the knowledge and skills bases of local governments (and their planners), and enhance their capacity to effectively implement state government planning and zoning policy.

#### FINDING 6.1

The Australian economy would benefit from further simplifications to state and territory planning and zoning schemes that expand the supply of retail space by simplifying business zones and removing unnecessary restrictions on the allowable use of land within each zone. Victoria is leading the way in this space, and should serve as a model for other states and territories to follow.

#### FINDING 6.2

The expected net benefits to the economy from state and territory government planning and zoning reforms will only be realised in full if local governments have the resources to effectively implement state and territory government policies consistently and as intended.

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<sup>30</sup> For more information see: <http://www.mainstreetaustralia.org.au/Content/Pub/ContentDetail.asp?lngContentID=49#Mission>.

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## 6.3 Retail tenancy leases

The Commission conducted an inquiry into retail tenancy leases in 2008 and made a number of recommendations designed to improve the operation of the retail tenancy market (PC 2008). In essence, the recommendations were focused on:

- improving, where practicable and cost effective, education, information and dispute resolution procedures
- moving towards self-regulation, rather than continued reliance on government legislation
- removing the more restrictive elements of retail tenancy legislation, including divisions between jurisdictions and the broader market for commercial tenancies, that impede contracting between firms.

The retail tenancy issue was examined again by the Commission in 2011 as part of its inquiry into the economic structure and performance of the retail sector (PC 2011a). This inquiry confirmed that the main concerns raised by stakeholders related to leasing arrangements within shopping centres (as opposed to other retail areas), and that planning and zoning constraints appeared to be the root cause of many of these concerns.

As noted in the 2011 inquiry (and in chapter 4 of this study), occupancy rates are extremely high in shopping centres in Australia due to strong demand for retail space in the face of constrained supply.<sup>31</sup> This places smaller retailers — who do not have the bargaining power of anchor tenants or chain specialty stores — in a very tough bargaining situation.

Removing unnecessary restrictions on competition and constraints on the supply and location of retail space through reforms to planning and zoning regulations would potentially increase competition between shopping centre landlords, and reduce the bargaining power of landlords vis-à-vis their tenants, by improving tenants' ability to relocate close by and preserve their businesses after lease expiry.

### **Progress on implementing previous Commission recommendations on retail tenancy leases**

As with planning and zoning reforms, progress since 2011 in implementing leading practices in retail tenancy leases has varied across jurisdictions. Some key developments include:

- In Victoria, the State Government made a number of changes to its retail tenancy legislation and regulations in 2012 and 2013, including removing some reporting

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<sup>31</sup> For example, the inquiry reported that the average occupancy rate within Westfield's centres in the United States was 90 per cent, compared with 99 per cent in Australia (PC 2011). This is consistent with the data on vacancy rates discussed in chapter 4.

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obligations for landlords (Department of State Development, Business and Innovation, pers. comm., 12 May 2014). In March 2013, the Victorian Government also announced a working group to consider the feasibility of introducing a Victorian retail lease register (Department of State Development, Business and Innovation, pers. comm., 12 May 2014).

- In New South Wales, the State Government is currently reviewing its retail lease legislation and is developing a standard lease for New South Wales that landlords can use voluntarily, and an online disclosure statement for landlords and retailers (Premier of New South Wales, sub. DR30, p. 2). Also, the Office of the NSW Small Business Commissioner, which was established in 2013, aims to give small businesses an independent statutory officer to advocate on their behalf, and to formally represent their interests within Government. In relation to retail tenancy lease issues, the Commissioner advocates helping small businesses, including small landlords and retailers, to ‘enjoy a more level playing field, which will help to reduce the adversarial nature of the relations in the sector and improve business outcomes’ (Office of the NSW Small Business Commissioner, pers. comm., 12 May 2014).
- In Western Australia, amendments to commercial tenancy laws, including changes to disclosure statements and relocation clauses, commenced on 1 January 2013 (Department of Commerce nd). The Queensland Government and the Northern Territory Government have reviewed their retail tenancy legislation. There appears to be no public commitment to respond to the Queensland review by a particular date. The Northern Territory is in the process of amending its business tenancies legislation (Department of the Chief Minister, pers. comm., 22 and 23 May 2014).

Progress towards more consistent retail tenancy laws across Australia may now be more difficult, however, following the disbanding of the National Retail Tenancy Working Group in 2012. The working group was established in 2008 under the Council of Australian Governments Small Business Ministerial Council as a mechanism to re-establish communication between jurisdictions and foster national harmonisation of retail lease regulation, in response to recommendations made by the Productivity Commission in its 2008 inquiry.

The working group initiated three main projects:

- a national disclosure statement for retail leases
- national data standards for reporting on retail leases
- nationally consistent terminology for retail leases.

However implementation by jurisdictions of the working group’s recommendations was partial and inconsistent. As noted by the Western Australian Small Business Development Corporation:

The NRTWG [National Retail Tenancy Working Group] was disbanded in 2012 after it was unable to achieve national harmonization on a number of key retail tenancy issues. The main reason for this was the variation in commercial tenancy legislation across States and Territories.



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Attempts by the working group to produce a nationally consistent disclosure statement were not able to be implemented and enforced without existing legislation being amended. As there was no appetite for this to occur at the State level, the NRTWG was unable to effectively introduce any significant changes. (sub. 9, p. 5)

On 25 June 2014 the Australian Senate referred an inquiry into the need for a national approach to retail leasing arrangements to the Senate Economics References Committee for inquiry and report by 30 October 2014. The terms of reference for the inquiry note the need for a national approach to retail leasing arrangements to create a fairer system and reduce the burden on small to medium businesses with associated benefits to landlords.

### Specific retail tenancy issues raised in this study

Submissions to this study have again raised concerns regarding aspects of retail tenancy leases. For example, a requirement that shopping centre tenants provide shopping centre owners with turnover data (as part of lease agreements) was raised by the Australian Retailers Association (sub. 14) and the Office of the Premier of New South Wales (sub. DR30). A primary concern is whether the provision of such information disadvantages smaller retailers in their rental negotiations with large landlords. On the other hand, the Shopping Centre Council of Australia is of the view that turnover data are ‘vital’ for shopping centre landlords, as well as for retailers:

Turnover information is necessary for proper market share analysis — to determine the overall financial performance of a shopping centre; the strengths and weaknesses of the centre's retail offer according to various retail categories; and if it is losing sales to a competitor. This information is critical for decisions on expansions and refurbishments of the centre, Shopping centres usually require major refurbishments, involving substantial amounts of capital, every 10 years or so. (sub. DR33, p. 2)

While this issue is contentious, it is not likely to be a substantive cost issue for the retail sector as a whole. First, for retailers in shopping centres it is not clear that occupancy costs would be significantly lower if legislation was introduced to stop landlords requesting turnover data in retail leases. Second, the vast majority of landlords do not use or require turnover data in their retail leases.

Another concern raised in submissions to this study relates to state and territory government legislation that require landlords to use licensed real estate agents in the preparation of retail tenancy leases. The Shopping Centre Council of Australia believes that, in regard to its clients at least, the regulations are outdated and unnecessary and should therefore be removed (sub. DR27). It estimates that removing these regulations would generate a cost saving to shopping centres of around \$6 million per year.

However the Commission has previously heard that these regulations likely benefit significant numbers of smaller retailers and large numbers of comparatively small owners of retail space (PC 2011a). For smaller retailers in large shopping centres, the existing

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provisions may also provide important protections that would no longer be available if large shopping centre owners were simply made exempt from the rules.

Given that the number of parties arguing to change these regulations (large shopping centre owners) is comparatively small, the best way to meet the needs of all parties is likely to be through direct negotiation between stakeholders and individual state and territory governments.

## **Where to on retail tenancy reform?**

Further improvements to the operation of retail tenancy markets in line with the acknowledged best practices suggested by the Commission in its 2008 study should remain a priority for state and territory governments. The key areas for reform include improving transparency, disclosure and dispute resolution, supporting a move to less prescriptive legislation, and ensuring greater national consistency.

The Commission continues to hold the view that many of the problems in the retail tenancy market could be addressed by relaxing planning and zoning controls that limit competition and restrict the availability of retail space. For example, allowing a greater number of shopping centres (particularly within existing activity centres or commercial zones) could resolve many of the core problems in the retail tenancy market. It would also benefit consumers by providing greater choice, convenience, and (potentially) lower prices.

### **FINDING 6.3**

The core problems in the market for retail tenancy leases will not be overcome until state and territory governments address the issue of planning and zoning controls that unduly limit competition and restrict the availability of retail space, particularly in relation to the supply of retail space in shopping centres.

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## 7 Labour cost issues in the retail industry

### Key points

- Participants in this study raised concerns about labour costs unduly affecting the overall cost of doing business for retailers in Australia. Specific concerns related to minimum and award wages, enterprise agreements, and penalty rates. Concerns were also raised about the consistency of decision making by the Fair Work Commission (FWC), as well as the overall level of 'flexibility' within the current industrial relations system.
- During consultations, many participants noted the forthcoming inquiry into Australia's workplace relations framework (to be conducted by the Commission) as a more appropriate forum to raise issues with the current system. The Commission agrees with this view, given that the retail sector's labour market should not be considered in isolation from the rest of the economy.
- In 2012, nearly 26 per cent of retail employees were reliant on the retail award, making it relatively more award-reliant compared with other Australian industries. Forty-two per cent of retail employees were covered by an enterprise agreement, and it appears that enterprise agreements are typically used by larger retail employers. A further 30 per cent of retail employees were covered by individual agreements.
- Several participants claimed that there is a strong link between the national minimum wage (NMW) and both award and enterprise agreement outcomes in the retail industry.
  - The rates of growth in the NMW and the retail award have moved in tandem since the commencement of the awards modernisation process in 2010.
  - Negotiated wage outcomes for retail employees covered by enterprise agreements tend to be closely aligned with the retail award decisions of the FWC. For 69 per cent of federally registered enterprise agreements covering retail employees, their wage increases were, at least in part, explicitly linked to the FWC decisions on the NMW.
- Employees in the retail industry earn less on average than those in most other industries, reflecting the relatively low skill levels required for the majority of retail positions. Among full-time adult employees, average weekly earnings (which include ordinary time earnings, penalty rates and on-costs such as superannuation) in the retail sector were around 70 per cent of the average across all industries in May 2014.
  - Over the period from 2008 to 2012, average annual growth in retail wages (in terms of average weekly total cash earnings for all methods of setting pay) was 3.8 per cent for the retail industry and 4.3 per cent for all industries.
- Penalty rates have larger effects on the labour costs of businesses where weekend trading is a major source of revenue. However, the extent of the impact is not clear as there is a dearth of quantitative evidence on the incidence of penalty rates in all Australian industries. Nevertheless, participants said that penalty rates have a disproportionate impact on small businesses.

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## 7.1 Introduction

Labour costs comprise a significant proportion of retailers' cost of doing business, whether they are based in Australia or overseas (chapters 3 and 4). In Australia, labour costs represent 47 per cent of the total cost of doing business for the sector. Participants in this study raised several issues associated with labour costs in the retail sector. Comments by the Pharmacy Guild of Australia exemplified the concerns of many businesses:

... [concerns include] the general level of wages in the sector as a percentage of overall operating expenses, the growth in wages relative to output prices, penalty rates, labour on-costs, the costs of negotiating enterprise bargaining agreements, and inconsistencies in the decisions of the Fair Work Commission. (sub. DR23, p. 2)

However, the Shop, Distributive and Allied Employees' Association (SDA) and the Australian Council of Trade Unions (ACTU) claimed that the overall industrial relations framework did not unnecessarily add to the cost of doing business, and that the retail sector was performing strongly. For example, the ACTU stated:

Australia's non-wage labour costs are low by OECD standards ...

Unit labour costs growth in [the wholesale, retail trade, accommodation and food services, and transportation and storage industry] group in Australia has been around average for the countries for which the OECD has data. This does not support the claims by some business groups that labour costs growth in Australia has exceeded growth elsewhere. (sub. DR28, pp. 4, 8)

Further, the SDA submitted that:

... the long term aggregate profitability of the retail sector has grown at a solid rate which has matched or out-performed other industries including manufacturing, wholesale trade, financial and insurance services and accommodation and food services. (sub. 6, p. 2)

In light of the forthcoming inquiry into Australia's workplace relations framework (Abetz 2013), some participants noted they would not submit information on industrial relations issues to this study. Workplace relations issues are not unique to the retail industry. This suggests that the issues are more appropriately addressed by an in-depth economywide inquiry into the workplace relations framework.

That said, submissions and consultations have highlighted three main areas of concern raised by many participants, namely wage setting and outcomes (section 7.2), penalty rates (section 7.3), and flexibility.

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## 7.2 Wage setting and outcomes

In common with other industries, the retail industry is covered by various pay-setting arrangements. In 2012, nearly 26 per cent of retail employees were reliant on the retail award, making them relatively more award-reliant compared to other Australian employees (figure 7.1). (The most award-reliant industry is accommodation and food services, with around 45 per cent of employees covered.) Forty-two per cent of retail employees were covered by enterprise agreements, and a further 30 per cent were covered by individual agreements.

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Figure 7.1 **Retail trade employees by methods of setting pay**  
Per cent of employees, 2008–2012<sup>a</sup>



<sup>a</sup> Data prior to 2008 represent a break in series associated with the change to the current ABS industry classifications, as well as the existence of previous industrial relations systems. The ABS data include state-based agreements, which represent around 10–15 per cent of the total number of enterprise agreements. Estimates of owner managers of incorporated enterprises are not shown.

Sources: ABS (Cat. no. 6306.0, 2009, 2011, 2013).

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The *General Retail Industry Award 2010* ('the retail award')<sup>32</sup> is one of 122 awards that apply across whole industries or occupations in Australia, and provides for minimum pay rates and employment conditions. Enterprise agreements are made at an enterprise level between employers and employees and cover the terms and conditions of employment (Fair Work Commission 2014a) (box 7.1). Data from the Department of Employment suggest that enterprise agreements tend to be used primarily by larger retailers (table 7.1).

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<sup>32</sup> Given the scope of this study, it has not been possible to assess other awards that may also apply in the retail industry such as the *Meat Industry Award 2010*, the *Pharmacy Industry Award 2010*, and the *Vehicle Manufacturing, Repair, Services and Retail Award 2010*.

## Box 7.1 Awards and enterprise agreements

### Awards

The FWC states:

Modern awards cover a whole industry or occupation, and provide a safety net of minimum pay rates and employment conditions. Awards are used as the benchmark for assessing enterprise agreements before approval.

Standard clauses in awards include: award flexibility; consultation; dispute resolution; types of employment; termination of employment; redundancy; minimum wages; national training wage; allowances; and superannuation.

### Enterprise agreements

The FWC states:

Enterprise agreements can be tailored to meet the needs of particular enterprises. An agreement must provide for an employee to be better off overall when conditions in the agreement are compared to the relevant award.

Enterprise agreements can include a broad range of matters such as: rates of pay; employment conditions; consultative mechanisms; and dispute resolution procedures.

Once an agreement has been negotiated, employees must vote on it. If a majority of employees vote in favour of the agreement, the agreement is submitted to the FWC for approval. The FWC assesses the agreement to ensure that it satisfies the legislative tests (Fair Work Act ss 186-187). Once the FWC approves the agreement, a decision is issued and the agreement is attached to the decision. The decision and the agreement are then published.

Sources: Fair Work Commission (2014b, 2014c, 2014d).

Table 7.1 Recent trends in federally registered enterprise agreements  
2008–2012<sup>a</sup>

		Number of agreements	AAWI <sup>b</sup>	Duration	Employees covered	Average number of employees covered per agreement
			Per cent	Years	('000s)	
2008	Retail trade	3584	3.5	2.8	1507.1	391.0
	All industries	73 463	4.1	2.8	7601.9	103.5
2010	Retail trade	7434	3.5	3.1	1584.7	213.2
	All industries	91 662	4.1	2.9	8643.7	94.3
2012	Retail trade	7505	3.5	2.9	1589.3	211.8
	All industries	91 492	4.0	2.9	10 213.0	111.6

<sup>a</sup> Average of the year to June in the respective years. <sup>b</sup> AAWI = average annual wage increase.

Source: Department of Employment (2014).

Recent decisions by the Fair Work Commission (FWC) and its predecessor demonstrate that there is a strong relationship between the national minimum wage (NMW) decisions and the various award determinations in the retail industry (table 7.2).

**Table 7.2 Recent minimum wage and retail award decisions**  
2011-12 to 2014-15

Year	NMW			GRIA Level 1		
	(\$ per hour	(\$ per week	Per cent increase	(\$ per hour	(\$ per week	Per cent increase
2011-12	\$15.51	\$589.30	3.4	\$17.03	\$647.30	3.4
2012-13	\$15.96	\$606.40	2.9	\$17.53	\$666.10	2.9
2013-14	\$16.37	\$622.20	2.6	\$17.98	\$683.40	2.6
2014-15	\$16.87	\$640.90	3.0	\$18.52	\$703.90	3.0

NMW = national minimum wage. GRIA Level 1 = General Retail Industry Award Employee Level 1.

Sources: *Annual Wage Review 2009-10* [2010] FWAFFB 4000; *Annual Wage Review 2010-11* [2011] FWAFFB 3400; *Annual Wage Review 2011-12* [2012] FWAFFB 5000; *Annual Wage Review 2012-13* [2013] FWCFFB 4000; *Annual Wage Review 2013-14* [2014] FWCFFB 3500; Fair Work Australia (2010), (2011), (2012); Fair Work Commission (2013), (2014e).

The awards stipulate minimum wage rates for different occupations, skills and industries, so decisions about the NMW percolate throughout the labour market. As noted by the Australian National Retailers Association (ANRA):

A key driver for basic wage costs in the retail sector is the national minimum wage decision, made as part of the Fair Work Commission's Annual Wage Review. This is because the retail sector is one of the more heavily award-reliant sectors in the Australian economy.

Indeed, the General Retail Industry Award (GRIA) 2010 in particular is a primary instrument for engagement of employees under the federal system and also as a (the) point of reference for negotiating enterprise bargaining agreements (EBA). This in turn makes the national minimum wage decision pivotal in determining the trajectory of wage costs for the sector. (sub. 16, p. 10)

Wage increases under enterprise agreements in the retail industry also tend to reflect the NMW decisions. Department of Employment data on federally registered enterprise agreements for March 2014 show that, of the 864 agreements, 594 (69 per cent) agreements' wage increases were, at least in part, directly related to NMW decisions.

As well as annual adjustments resulting from changes to the NMW, all awards are currently subject to a mandatory four-yearly review, conducted by the FWC (and can also be reviewed on request if anomalies arise). The review presents an opportunity for participants — within and outside of the retail industry — to raise issues with the awards process, and seek to improve the efficacy of the industrial relations system.

## Wages and earnings outcomes

Employees in the retail industry earn less on average than those in most other industries, reflecting the relatively low skill levels required for the majority of retail positions. Among full-time adult employees, average weekly earnings (which include ordinary time earnings,

penalty rates and on-costs such as superannuation) in the retail sector were around 70 per cent of the average across all industries in May 2014 (ABS 2014b).

The *average annual wage increase* (Department of Employment data) under retail-based enterprise agreements has consistently been below the wage increases for other Australian industries. However, when enterprise agreement retail workers' *average weekly total cash earnings* (ABS data) are considered, the total remuneration increases are much higher. Over the period from 2008 to 2012, average annual growth in retail wages (in terms of average weekly total cash earnings for all methods of setting pay) was 3.8 per cent for the retail industry and 4.3 per cent for all industries (table 7.3).

The divergence between the two estimates of the rate of wage growth in collective agreements may at least partly be explained by compositional changes in payments to labour. The ABS calculation is a gross figure per employee (not per hour) and includes any salary sacrificing, applicable penalty rates, overtime and the value of superannuation. Accordingly, any compositional changes in working arrangements — such as more work at penalty rates or changes in the full-time/part-time mix of employees — will affect average earnings, but not the wage rate.

**Table 7.3 Retail trade employees by methods of setting pay**  
Average weekly total cash earnings, 2008–2012<sup>a</sup>

		<i>Award only</i>	<i>Enterprise agreement</i>	<i>Individual agreement</i>	<i>All methods of setting pay<sup>b</sup></i>
2008 <sup>c</sup>	Retail trade	\$420.50	\$400.60	\$872.30	\$571.80
	All industries	\$485.90	\$979.30	\$1116.80	\$957.90
2010 <sup>d</sup>	Retail trade	\$460.70	\$416.00	\$925.20	\$608.80
	All industries	\$520.00	\$1050.60	\$1146.10	\$1010.30
2012 <sup>e</sup>	Retail trade	\$475.80	\$490.50	\$972.40	\$643.50
	All industries	\$633.80	\$1150.80	\$1277.20	\$1122.60
AAGR (%)	Retail trade	3.3	5.6	2.9	3.8
AAGR (%)	All industries	7.6	4.4	3.6	4.3

<sup>a</sup> Data prior to 2008 represent a break in series associated with the change to the current ABS industry classifications, as well as the existence of previous industrial relations systems. <sup>b</sup> All methods of setting pay is a weighted average of each method of setting pay. <sup>c</sup> Last pay period ending on or before 15 August 2008. <sup>d</sup> Last pay period ending on or before 21 May 2010. <sup>e</sup> Last pay period ending on or before May 2012. AAGR = average annual growth rate, 2008–2012.

Sources: ABS (2009, 2011, 2013b).



## 7.3 Penalty rates

Employees that work outside of ‘ordinary hours’ are eligible for penalty rates. Table 7.4 illustrates the currently applicable penalty rates under the retail award. These penalty rates commenced on 1 January 2010 and have not changed since. In practical terms though, since the relevant award wage has been increasing annually, the absolute level of penalty pay has been increasing, despite no change in the applicable penalty rate.

**Table 7.4 Applicable penalty rates**  
Under the *General Retail Industry Award 2010*<sup>a</sup>

	Penalty rate	Employees that penalty rate applies to:		
		Full-time	Part-time	Casual
Monday to Friday 6 pm onwards	25%	✓	✓	<b>x</b>
Saturday between 7 am and 6 pm	25%	✓	✓	<b>x<sup>b</sup></b>
Sunday (anytime)	100%	✓	✓	<b>✓<sup>c</sup></b>
Public holidays	150%	✓	✓	<b>✓<sup>c</sup></b>

<sup>a</sup> Casual employees receive a standard 25 per cent casual loading. Penalty rates also apply to post-midnight shiftwork. Ordinary hours (and therefore penalty rates) differ for newsagencies, video shops, and retailers with extending trading hours. <sup>b</sup> Casual employees receive an additional 10 per cent in addition to a 25 per cent casual loading. <sup>c</sup> Casual employees do not receive a 25 per cent casual loading.

Source: *General Retail Industry Award 2010*.

Penalty rates are not unique to the retail industry. Of the current 122 awards across Australia, 116 awards (that is, 95 per cent) include penalty rate provisions (DEEWR 2012b, p. 12). However, there is a dearth of quantitative evidence on the incidence of penalty rates in any Australian industry, including retail. Penalty rates will have larger effects on the labour costs of businesses where weekend trading is a major source of revenue. Anecdotally, it has been suggested that penalty rates have a disproportionate impact on small businesses (box 7.2; SLCEEWR 2013).

Many participants were concerned about the impact of penalty rates on business profitability, small businesses, and employment. Key issues were summarised by the Australian Liquor Stores Association as:

What may be normal hours for a business model such as an office is quite different for a retail liquor business who employs staff to cover their peak trading times after 5:00pm Monday to Sunday and during the day on weekends.

Penalty rates developed under the traditional model have a big impact on restricting opportunity for additional staff, often contributing to sub-standard service levels in the retail environment compared to other countries.

Staff members cost more to employ when trading is conducted outside 9am – 5pm and some small businesses choose to reduce the hours of trading or the hours of employees. Many small businesses who are forced to compound compliance costs, time and complexity to pay penalty

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rates at a higher rate, often choose to forgo additional staff and where possible the shop owner will work themselves or only engage family members. (sub. DR31, p. 5)

## **Box 7.2      Participants' views on the impact of penalty rates in the retail industry**

### **Impact on profitability:**

The Shopping Centre Council of Australia:

... an increasing number of retailers in shopping centre[s] are reluctant to open their shops on Sundays and public holidays, despite these days being good trading days, because the penalty rates which are required to be paid to staff means such trading is only marginally profitable or is unprofitable. (sub. 17, p. 19)

National Retail Association:

... businesses have reported that they simply no longer open their doors on Sundays. This not only denies their staff the opportunity of work, but it also hinders profitability by forcing the business to recover its fixed costs over a shorter trading period each week. (sub. 18, p. 6)

Chamber of Commerce and Industry Queensland:

Simply put, employers' ability to trade at times when it is most profitable to do so is restricted by penalty rate requirements. (sub. DR29, p. 4)

### **Impact on small business:**

National Retail Association:

... the current workplace relations regime has prompted a significant proportion of smaller retailers either to remain closed on Sundays, or to limit employment at those locations to proprietors and family members only, thus obviating the need to pay significant penalty rates to staff. (sub. 18, p. 6)

Office of the Australian Small Business Commissioner:

The impact of penalty rates on business operations, particularly on the ability to flexibly use employees and for owners to choose when they personally work in a small business ... (sub. DR22, p. 2)

Master Grocers Australia and Liquor Retailers Australia:

The cost of employing an adult casual employee to work on Sunday in the retail industry under the General Retail Industry Award is \$37.05 per hour and on a public holiday the hourly rate is \$50.94 cents. ... However, the formidable cost to the independent retailer, will have the inevitable result that the business will disappear or redundancies will increase. (sub. DR26, p. 9)

Chamber of Commerce and Industry Queensland:

... businesses are debilitated by general wage growth and the imposition of penalty rates during 'unsociable hours'. It is without doubt that the single most significant issue for small and medium enterprise operating in the retail sector is penalty rates. (sub. DR29, p. 4)

### **Impact on employment:**

Swimming Pool and Spa Alliance:

Penalty rates increase labour costs, reduce employment, and hamper business attempts to serve customers on the most important trading days on the calendar: late nights, weekends, and public holidays. (sub. 5, p. 5)

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## History and present day views

Penalty rates have existed in Australia for more than 100 years.<sup>33</sup> By 1919, it was already an industry standard that if workers were required to work on Sundays they were entitled to double pay. A standard working week for employees covered by the gas award that prevailed at the time prescribed a working week (for most employees) to be six days per week, to a total of 48 working hours per week, after which overtime rates applied.

In the *Gas Employees Case*,<sup>34</sup> the penalty rates specifically for work on Sundays was justified on the following grounds:

... because of the grievance of losing Sunday itself—the day for family and social and religious reunions, the day on which one’s friends are free, the day that is the most valuable for rest and amenity under our social habits ... (at 469)

Initial decisions to impose penalty rates were unlikely to have had much impact on the retail industry given consumer preferences at the time and the fact that shopping hour restrictions were widespread. However, consumer preferences and expectations have changed due to a combination of higher incomes, changes in taste from social and cultural influences, as well as technological changes. Further, in some jurisdictions, deregulated trading hours have meant that the incidence of penalty rates in the retail industry is now broader.

A number of participants in the ongoing Australian Government competition policy review stated that the imposition of penalty rates was out of step with contemporary societal Australian lifestyles (box 7.3).

### **Box 7.3      Submissions to the competition policy review argue that penalty rates are no longer appropriate in Australia**

Australasian Association of Convenience Stores:

We have previously discussed the fact that people no longer work a 9-to-5, Monday to Friday working week by default. In many cases people desire night work or weekend work to fit in with their other family, study or recreational pursuits. (p. 7)

Australian Retail Association:

The recognition of the difficulties faced by retailers working under an award structure that imposes higher labour costs at times when consumers want to shop is causing major distortions in the ability for retailers to trade competitively. This is becoming increasingly problematic as weekends, after 6pm and public holiday rates continue to establish themselves as important trading times with many retailers not finding it economically viable to trade at these times. (p. 8)

Sources: Australasian Association of Convenience Stores (2014); Australian Retailers Association (2014).

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<sup>33</sup> See, for example, the schedule attached to the minimum wage decision in *Ex parte HV McKay* (1907) 2 CAR 1.

<sup>34</sup> *Federated Gas Employees’ Industrial Union v Geelong Gas Company* [1919] 13 CAR 437.

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There have been several recent developments regarding penalty rates in the retail industry (box 7.4).

#### **Box 7.4 Recent developments relating to penalty rates**

The process of award modernisation has had some impact on the application of penalty rates. Prior to the commencement of the *Fair Work Act 2009* (Cwlth), there were over 1500 awards. In March 2008, the Australian Industrial Relations Commission (AIRC) began the awards modernisation process, reducing the number of awards to 122, from 1 January 2010. Analysis by the Department of Education, Employment and Workplace Relations (DEEWR) indicated that:

- modern awards did not introduce new penalty rate entitlements; and
- penalty rates included in modern awards generally reflected rates commonly found in existing state awards. (DEEWR 2012b, p. 12)

Nevertheless, DEEWR stated that between 27 March 2006 and 6 May 2007, 'there was scope for newly established federal system employers to engage employees on terms and conditions which did not include penalties' (DEEWR 2012a, p. 2). Any pre-existing businesses were covered by 'pre-reform award' rules and were therefore obligated to pay penalty rates. Newly established employers (and their employees) were covered by a modern award as a result of the modernisation process and, as such, since 1 January 2010, have transitioned to the penalty rates payable under the applicable award. The transition period ended on 1 July 2014 and now all award-covered employees are entitled to be paid penalty rates in accordance with the award.

Separately, in 2012 there was a legislative amendment to the Fair Work Act which effectively enshrined the existence of penalty rates (but not a quantum) in awards. However, in both of these developments no data exist on outcomes which can be attributed to these changes.

Under the Fair Work Act, there is also provision for individual flexibility agreements (IFAs) that allow an employee to forgo penalty rates in exchange for some other benefit/s, providing that the employee is better off overall: ss. 144(4)(c), 203(4).

#### **A new regulatory development may be important**

In May 2014, the Full Bench of the FWC handed down a decision<sup>35</sup> to reduce the applicable penalty rate to introductory level staff covered by the *Restaurant Industry Award 2010*. The Full Bench found that the prevailing Sunday penalty rate of 50 per cent was overall not too high, and that both career restaurant industry workers and transient lower-skilled casual employees should be compensated for the social costs of working on Sundays. However, the Full Bench went on to state:

... we consider that for this latter category of primarily younger workers, the superimposition of the casual loading of 25% in addition to [sic] the Sunday penalty rate of 50%, resulting in a total loading of 75%, would tend to overcompensate them for working on Sundays and is more than is required to attract them to work on that day. (at [138])

The Full Bench noted that the social costs associated with working on Sundays applied equally to the retail industry and the restaurant industry. It is currently unclear what effect

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<sup>35</sup> *Restaurant and Catering Association of Victoria* [2014] FWCFB 1996.

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(if any) this decision may have on penalty rates in the retail industry. Regarding the decision, the Council of Small Business of Australia stated:

... that recently the Fair Work Commission decreased penalty rates in the Hospitality Industry and we hope and expect that the same will occur in the retail sector. Currently penalty rates for Sundays are at least double time and penalty rates for public holidays are triple time. This makes opening a shop on those days a loss making event. Many businesses have had to close on those days. (sub. DR20, p. 1)

The Small Business Development Corporation noted:

... that the Fair Work Commission [decision] to reduce Sunday penalty rates by 25 per cent ... may pave the way for further reforms in the retail industry. In making this decision however, the Fair Work Commission reiterated its stance that “working on Sundays involves a loss of family time and personal interaction upon which special emphasis is placed by Australian society”. For this reason, it appears unlikely that penalty rates will be removed completely in the foreseeable future. (sub. DR36, p. 5)

## 7.4 Other matters

Participants in this study also raised concerns about a lack of ‘flexibility’ in the current system (box 7.5).

### **Box 7.5      Participants’ concerns about the lack of flexibility in the current industrial relations system**

Swimming Pool and Spa Alliance:

Australia’s industrial relations regulation is too rigid, which compromises retail economic growth and obstructs productivity gains.

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

Chamber of Commerce and Industry Queensland:

The correlation between growth in wages (in particular penalty rate increases under the award modernisation process), and the inflexibility of the current national workplace relations system, has meant that businesses are unable to effectively offset wage growth with an increase in productivity levels.

... As the retail industry is highly reliant on flexibility in the workplace, the business community argues the current Fair Work system, particularly penalty rates and the ongoing increase in the level of award wages, substantially increases total employment costs and negatively impacts operational flexibility. (sub. DR29, pp. 3–4)

Gilmour’s:

In the 95 years in which we have operated, we have embraced a traditional retailers’ economic view of wages – that more wages are good for retailers, because more wages mean more spending. We continue to hold this view. But our plea is for more flexibility as to when we employ staff. (sub. 11, p. 5)

The Australian Retailers Association (sub. 14, p. 1) noted that Australia had ‘an inflexible wages system’ and the National Retail Association (sub. DR32, p. 4) regarded workplace inflexibility as a serious impediment to establishing online retail in Australia.

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Additionally, the National Retail Association (and supported by the Pharmacy Guild of Australia (sub. DR23, p. 2)) expressed concern in the current level of consistency in decision making by the FWC:

One of the greatest frustrations the retail industry has with the current system is the wide variance in outcomes and the discrepancies in decision making. There are many examples where the Commission has eschewed a common sense approach to the matters before it, and where agreements have been approved outside the spirit of the legislation. Based on our discussions with other industry bodies, we believe this frustration is not limited to the retail sector. (sub. 18, p. 8)

These concerns are best dealt with by an in-depth inquiry. Indeed, as pointed out by the National Retail Association, these issues are not isolated to the retail sector. It would therefore be inappropriate for the Commission to examine these issues solely through the lens of the retail industry.

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## 8 Other costs and regulatory burdens

### Key points

- Although labour and occupancy costs typically constitute the main costs of doing business for retailers, participants were also concerned about other areas where they considered the costs they face were unwarranted or excessive.
- Most of the costs that participants identified as unwarranted or excessive were claimed to derive from deficiencies in the regulatory environment relating to:
  - the presence of multiple regulators (and, thus, multiple compliance costs)
  - poorly developed regulation (with regulation not justified on a benefit–cost basis or compliance costs in excess of those that are ‘efficient’)
  - inconsistent regulations between and/or within jurisdictions (with retailers operating in more than one location subject to compliance costs for multiple sets of differing regulation).
- Rather than assess the merits of participants’ criticism about particular regulations, the Commission has drawn on its previous detailed work on regulation and considered participants’ concerns in the context of the principles of best practice regulation.
- Businesses’ concerns about the regulatory environment are not new, nor confined to the retail industry. They reflect broader concerns about the need for ‘good’ or best practice regulation.
- While the Australian, state/territory and local governments have instituted reforms, ongoing and new concerns emphasise the need for governments to:
  - continue efforts to review and reform existing regulations that are unnecessarily burdensome, and
  - ensure the process of making regulation follows best practice in order to avoid new regulation that is unjustified or has excessive compliance costs.
- At the local government level, many councils lack the resources needed to effectively and consistently apply state and territory government legislation. Addressing concerns about unnecessary or inconsistent regulation at this level will require state and territory governments to assume a greater role in building and maintaining local government regulatory capacity.

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## 8.1 Introduction

Labour and occupancy costs typically constitute the main costs of doing business for retailers. However, participants were also concerned about other areas where they considered costs imposed on them by government action were unwarranted or excessive.

Participants' concerns in these areas covered: high regulatory compliance costs; excessive utility charges (especially electricity); controls on the interstate movement of goods; superannuation and paid parental leave processing arrangements; and the incidence and level of some taxes and charges.

In addition, some participants raised concerns about the adverse effects on their business arising from tariffs, the Low Value Threshold (LVT) for applying taxes and charges on imports; shortcomings in the Tourist Reimbursement Scheme for GST; and parallel import restrictions.

Industry concerns about these areas are not new, and were also raised in the Commission's 2011 inquiry into the retail industry. Moreover, concerns about deficiencies in the regulatory environment mirror broader concerns about 'good' or best practice regulation. Rather than assessing the merit of participants' criticism about particular regulations the Commission has drawn on its previous work on regulation and considered participants' concerns in the context of principles of best practice regulation.

## 8.2 Excessive regulation and compliance costs

While most businesses would agree that some regulation is necessary, it is important that only regulation that is justified on benefit–cost grounds is implemented and that any regulation be as efficient as possible to avoid excessive compliance costs (PC 2012c).

Participants' comments on the regulatory burden they face (box 8.1) reinforces the need for governments to remain committed to the principles of best practice regulation in order to achieve this objective (box 8.2).

Most of the costs that participants identified as being unwarranted or excessive they attributed to deficiencies in the regulatory process, including:

- the presence of multiple regulators (and, thus, multiple compliance costs)
- poorly developed regulation (with regulation not justified on a benefit–cost basis or compliance costs in excess of those that are 'efficient')
- inconsistent regulations (and their implementation) between and/or within jurisdictions (with retailers operating in more than one location subject to compliance costs for multiple sets of differing regulation).



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### **Box 8.1      Participants' comments on the general burden of regulation**

The Australian Retailers Association (ARA) noted:

... a recent ARA/ACCI report shows 70 per cent of businesses had their red tape burden increased in the last 12 months ... Two thirds of those surveyed indicated that regulatory requirements had a negative impact on their business, and a shocking 40 per cent of businesses reported that regulatory requirements had prevented them from making changes to grow their business. (sub. 14, p. 19)

Chamber of Commerce and Industry Queensland (CCIQ) provided case studies for a supermarket and a motor vehicle dealership, highlighting the significance of regulation compliance costs (in the case of the supermarket, compliance costs represent about 10 per cent of their annual profit) (sub. DR29).

The Australian Liquor Stores Association (ALSA) raised issues about the red tape burden on small business, including unnecessary information being collected via multiple collection points. It cited an estimate by the NSW Chamber of Commerce that, in 2006, the average business in New South Wales spent 400 hours a year complying with regulations or meeting legal obligations (sub. DR31).

The Pharmacy Guild of Australia endorsed the view that the costs of doing business in the retail sector are inflated by unnecessary regulations, and that government progress in addressing this problem has been slow and patchy (sub. DR23).

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### **Box 8.2      Principles of best practice regulation**

COAG has agreed that all governments will ensure that regulatory processes in their jurisdiction are consistent with the following principles:

1. establishing a case for action before addressing a problem
2. range of feasible policy options must be considered, including self-regulatory, co-regulatory and non-regulatory approaches, and their benefits and costs assessed
3. adopting the option that generates the greatest net benefit for the community
4. in accordance with the Competition Principles Agreement, legislation should not restrict competition unless it can be demonstrated that:
  - (a) the benefits of the restrictions to the community as a whole outweigh the costs
  - (b) the objectives of the regulation can only be achieved by restricting competition
5. providing effective guidance to relevant regulators and regulated parties in order to ensure that the policy intent and expected compliance requirements of the regulation are clear
6. ensuring that regulation remains relevant and effective over time
7. consulting effectively with affected key stakeholders at all stages of the regulatory cycle
8. government action should be effective and proportional to the issue being addressed.

Source: COAG (2007).

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## Multiple regulators

Coles and the Australian National Retailers Association (ANRA) highlighted the multiple regulators that retailers are answerable to, and the added costs that their overlapping (and differing) requirements impose on retailers. Submissions to the Australian Government's competition policy review have provided similar information (for example, Woolworths 2014, p. 68).

Coles noted that there is, on average, one special purpose national regulator for each aisle of a typical supermarket — and that is not including state-based regulators (table 8.1). In several cases some products are regulated by several bodies.

ANRA provided the example of multiple regulators for hardware and garden retailers and called for streamlining regulatory requirements where contact is made with multiple agencies, in order to reduce the regulatory red tape burden on retailers (sub. 16). ANRA also noted the burden particularly faced by larger retailers arising from the multiplicity of regulations and regulators across jurisdictions:

Working practices and remuneration outcomes for the road transport system are complex and regulated via a number of legislative instruments across numerous jurisdictions. ... The raft of regulations means that large operators, including some ANRA members, have vast and complex systems and processes in place to meet their obligations. (sub. 16, pp. 11–12)

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**Table 8.1      National level regulators and product coverage**

<i>Regulator</i>	<i>Product coverage</i>	<i>Estimated items affected</i>
FSANZ	packaged food, ingredients, labelling, chemical residues in food (in combination with APVMA)	20 000+
APVMA	some pet supplies, chemical residues in food (with FSANZ), fly spray, insect candles, pool and spa chemicals, some garden supplies	2 000+
ACCC	country of origin, labelling, mandatory reporting of incidents (as well as some broad-based regulation)	20 000+
NICNAS	chemicals such as detergents, cleaners and some personal care products	3 000
NTC	transport of dangerous goods	5 000
Biosecurity	imported food items (on behalf of FSANZ)	500+
TGA	vitamin supplements, over-the-counter medicines	1 000+
NMI	weights and measures, across both food and grocery items	20 000+

*Source:* Coles (sub. 7, p. 8).

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## Poorly developed regulation

Participants provided examples of existing regulation that they considered to be poorly developed or unwarranted, and which resulted in excessive compliance costs for their businesses. These included:

- restrictions on times for delivery and pickup/waste disposal
- liquor licensing regulation in Queensland that requires an applicant to own a hotel before being eligible to receive approval for off-licence liquor retailing
- product labelling, packaging and safety laws that impose unjustified or excessive compliance costs
- quarantine and other controls on the interstate movement of goods
- legislated container deposit schemes
- regulation in Victoria (to be repealed) banning the sale of plastic knives to minors.

The Australian Automotive Aftermarket Association (AAAA) also highlighted draft regulations in New South Wales that would require a licensed mechanic to fit items such as car floor mats and, in the process, increase the cost of doing business for no additional benefit to consumer safety (sub. DR21). The AAAA observed that these draft regulations (contained in a public Regulatory Impact Statement seeking stakeholders' comment) did not meet the fundamental principle that regulation should only be introduced where the imposed burden does not outweigh the expected benefit:

In many cases ... there is no clear and full justification for these regulations and no technical assessment. In this age of regulatory scrutiny, we are constantly surprised by the degree to which government agencies seek to design and implement regulations that do not add value, where the costs outweigh the benefits, result in consumer detriment and finally, are not subject to true regulatory impact assessments.

The fundamental principle of industry regulation is that it should only be introduced where the imposed burden on the economy does not outweigh the perceived benefit; in the instance outlined above, this is not the case. (sub. DR21, p. 7)

Subsequent to its submission to this study, the AAAA met with NSW Fair Trading to discuss its concerns with the draft regulations. As a result of those discussions and the Commission drawing this matter to the attention of New South Wales Government officials working on regulatory reforms, the draft regulations are expected to be amended to resolve the AAAA's concerns (NSW Department of Premier and Cabinet, pers. comm., 23 July 2014).

This example highlights the importance of common sense considerations in formulating regulations, early consultation with stakeholders before the draft legislation stage, draft legislation being available for consultation and governments' commitment to this process as standard practice for developing regulations.

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## Restrictions on delivery and pickup times

Concerns about excessive noise near residential premises have led to restrictions on delivery times to retail stores that, in turn, compromise the effectiveness and efficiency of those businesses' transport logistics systems, and drive up their cost of doing business.

Restrictions on the time of transportation are aimed at reducing noise and light disturbances at night for local residents. Time of transportation restrictions can differ between local areas but are generally imposed from 6 pm to 7 am. However, this means more traffic congestion in peak hours. (Coles, sub. 7, p. 13)

The efficiency of retailers' logistics operations is inhibited by restrictions on the time and type of vehicles that can be used for freight operations. ... Lifting the curfews on deliveries would allow retailers to increase their operational efficiency and deliver products to consumers at a lower cost. (ANRA, sub. 16, pp. 13–14)

A large retailer also advised the Commission that many of its stores also have restrictions on loading and waste removal times. Among the examples it provided were the restrictions faced by an inner Sydney store:

Heavy vehicle movements and loading dock activities shall be restricted to between the hours of 8 am to 5 pm Monday to Friday and 9 am to 1 pm Saturday. No heavy vehicle movement and/or loading dock activities are to occur on Sundays or public holidays. Given that deliveries are not allowed from Saturday lunch to Monday morning (Tuesday morning on a long weekend), this means we cannot get fresh milk, dairy, bread and newspapers into the site over this time, nor can we have waste pickups. This becomes even more challenging over Christmas and Easter, the busiest trading times of the year and also the warmest months when waste must be carefully managed to control odour and vermin. (pers. comm., July 2014)

The National Retail Association (NRA) saw this as an example of poor regulation, as proscribing delivery at certain times was an indirect (and inefficient) way of achieving a desired outcome:

If the desired outcome was a noise limit at certain times of the day, then government should regulate — and enforce — allowable noise and leave it to the business operator to determine how that can be achieved in the most cost-effective way. (sub. DR32, p. 5)

Examples of how retailers can mitigate excessive noise (other than cessation of deliveries) include the use of turntables (allowing trucks to drive into and out of stores and so avoiding the reversing 'beeping' noise) and the site-specific installation of acoustic barriers or acoustic insulation.

Similarly, Coles and the ARA argued for more outcomes-based regulation:

Noise standards could be provided for business operations during sensitive 'evening' and 'morning' periods. (Coles, sub. 7, p. 18)

An emphasis on the shift from a detailed and prescriptive 'input-based' approach to a broader 'output-oriented' approach. Businesses should be given flexibility in meeting the aims of regulations rather than ... having to meet set obligations. (ARA, sub. 14, p. 19)

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Such an approach would be consistent with best practice principles for the design and implementation of regulation, noted above (box 8.2).

### Liquor licensing requirements

Liquor licensing regulation has been criticised in submissions to the competition policy review. In that review, some retailers drew attention to Queensland's liquor licensing laws, which require a retailer to own a hotel as a prerequisite for approval for liquor retailing. While this requirement was primarily criticised as an obstacle to competition in the liquor retailing market, this prerequisite (which forced those wishing to enter liquor retailing to purchase a hotel business) also increased the cost of doing business. Australian United Retailers Limited (FoodWorks), for example, noted:

Current State legislation requires ownership of a hotel as a pre-requisite to running liquor stores. ... Coles and Woolworths have spent considerable amounts in buying up hotels in Queensland to gain access to freestanding liquor licences. (FoodWorks 2014, p. 23)

The draft report of the competition policy review considered that while the risk of harm from problem drinking is a clear justification for regulation of liquor retailing, there is no case to exempt regulation in this area from ongoing review to ensure that it is meeting its stated objectives at least cost to consumers (Competition Policy Review Panel 2014b, p. 109; ABS 2014k, p. 109).

### Labelling, packaging and safety laws

Some submissions raised concerns about unnecessary product labelling, packaging and safety regulation and about the excessive cost of achieving regulatory compliance even where such regulation is justified.

The NRA, for example, observed that for the sector generally:

The retail sector is littered with examples of packaging and signage requirements which at best can only be described as unnecessary red tape. ... Some states go so far as to stipulate the font and size of in-store sign-writing, but these requirements vary, creating significant administrative expense for businesses. (sub. 18, pp. 9–10)

Although package labelling for food products can deliver potential benefits to consumers in the form of better information regarding product content, Coles criticised the regulatory process that developed some of the labelling requirements. It claimed that a Regulatory Impact Statement was not prepared as part of the initial development of the Health Star Rating system (which would cost the industry \$200 million) (sub. 7, p. 4). Information from the Front-of-Pack Food Labelling Secretariat confirmed that no Regulatory Impact Statement was commissioned for the introduction of the Health Star Rating system (pers. comm., 28 August 2014).

However, since that submission, the Australia and New Zealand Ministerial Forum on Food Regulation has agreed that the system be implemented voluntarily over the next five

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years: an approach that has the potential to substantially reduce the cost of the scheme to industry (Department of Health 2014).

ANRA, too, was critical of the integrity of some new regulation, noting that it was at odds with COAG agreed principles for best practice regulation:

There are also recent examples of developments in food labelling requirements that have occurred without consideration of COAG's agreed principles for best practice regulation. ... the (former) New South Wales and Australian Capital Territory Governments introduced energy content (kJ) labelling requirements for freshly prepared in-store 'standard' food items. ... ANRA is not aware of any regulatory impact assessment ... prior to [introducing] the relevant legislation ... (sub. 16, p. 16)

Bicycle Industries Australia was also critical of what it viewed as excessive product safety compliance costs it must meet to operate in its retail market:

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

## Quarantine and other controls on the interstate movement of goods

Quarantine regulation and other controls over interstate movement of goods add to retailers' cost of doing business. Examples include restrictions on shipping potatoes into Western Australia and additional packaging and treatment requirements applying to a range of food products before they can be commercially imported into Tasmania (Coles, sub. 7). While biosecurity issues underpin these restrictions, it is important that they (as with any regulations) are regularly reviewed to ensure the benefits continue to exceed the costs, and remain justified in the face of changing circumstances.

## Container deposit legislation

Coles identified container deposit legislation as an example of poorly developed regulation that imposed excessive costs as a consequence:

COAG analysis shows a [container deposit scheme] is 28 times more expensive than industry alternatives capable of delivering the same environmental outcome. Container Deposit Schemes [CDS] exist in South Australia and (pending) in the Northern Territory with other States reportedly considering their options. A wider CDS would ... add **at least \$300 to an average shopping basket per annum** ... [emphasis in original] (sub. 7, p. 7)

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## Restrictions on the sale of plastic knives to minors

Woolworths provided evidence of the cost to them of enforcing a Victorian regulation that prohibits the sale of plastic knives to minors, despite the likelihood that enforcing the ban arguably does not make the community any safer than it would be otherwise (box 8.3).

### **Box 8.3      The ban on sales of plastic knives to minors in Victoria**

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

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

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

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

Sources: Victoria Police (nd); Woolworths (sub. 13).

In January 2014, the Acting Premier and Treasurer of Victoria announced 36 'red tape reforms' following consultations with businesses by the Victorian Red Tape Commissioner. These reforms included lifting the ban on the sale of plastic knives to minors. A Bill containing this amendment on the sale of plastic knives is listed for debate in Victoria's Legislative Assembly, although this may not occur in the limited sitting days available before the Victorian elections in November 2014 (Department of Justice, Victoria, pers. comm., 19 September 2014).

## **Inconsistent regulation between and within jurisdictions**

Even where regulation is justified and imposes efficient compliance costs, when that regulation (or its implementation) differs between or within jurisdictions, retailers operating in more than one location incur added costs from facing multiple and differing compliance requirements.

Compliance costs for retailers that operate nationally or in more than one state create an enormous financial burden on businesses by asking them to replicate processes which include unnecessary costs, administrative tasks, resources and sizeable and unnecessary delays. (Swimming Pool And Spa Alliance, sub. 5, p. 10)

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The current competition policy review received submissions detailing similar concerns from retailers. For example, in its submission to that review, Woolworths made a general appeal for Australian regulations to be more consistent across jurisdictions:

Laws and regulations should enable Australian businesses to be more internationally competitive and, where applicable, align with best practice. ... there are many opportunities to remove impediments so that Australian businesses can drive more economic growth and productivity for the benefit of consumers. For example, ... Inconsistent laws, regulations and licensing restrictions should be harmonised to reduce complexity and burden on business ... (Woolworths 2014, pp. 48, 56)

### Differing licensing regulations increase the cost of doing business

Participants also drew attention to the licensing regulations around the sale of liquor and tobacco that differed between jurisdictions and thus, they argued, imposed unnecessary costs on their business. Coles, for example, noted:

While the Commonwealth, State and Territory Governments have had a national policy for addressing alcohol, tobacco and other drugs since 1985, there is no national agreement on how to achieve the objectives in this policy.

The lack of national agreement on the approach to regulating tobacco means that Coles, as a national retailer, has to comply with varying State and Territory's interpretation — resulting in differing policies in regard to signage, display, licensing, ticketing, definitions of tobacco products and sales to minors for each jurisdiction. This situation applies equally to liquor regulation. (sub. 7, p. 12)

Coles and ALSA raised similar concerns about regulations governing the responsible service of alcohol (RSA):

We ... believe that RSA training undertaken in other States and Territories should be recognised in all States and Territories. ... This would be consistent with mutual recognition laws and the commitment to reduce red tape for businesses. (Coles, sub. 7, p. 13)

... RSA certification is not transferrable across all states and territories. It is possible for a person ... with the necessary RSA certification for one state ... if that person chooses to move interstate ... they are required to undertake additional RSA certification to comply in the new State. This imposes additional ... costs on business owners [as] ... business owners generally pay for their prospective or existing staff to acquire RSA certification, as they see this as a necessary cost of doing business ... (ALSA, sub. DR31, p. 3)



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## Inconsistent product labelling and packaging and food safety laws

Some participants were critical of inconsistencies between and within jurisdictions in product labelling and packaging and food safety laws. The NRA, for example, said:

... the laws governing product technical and safety standards are a tangle of bureaucratic red tape. In many cases products that are approved for sale in one state are banned in others (such as the example of honey detailed by Coles ... in its submission to this inquiry). In the case of the electrical industry, there is no national regime for approving and enforcing product safety standards ... (sub. 18, p. 10)

Other participants, such as Coles and ANRA, drew attention to the subjective and unpredictable interpretation of regulations, sometimes within the same jurisdiction and involving the same regulatory officer:

Local government is responsible for the administration and enforcement of much legislation enacted by State and Federal Authorities. However, ... As there is no coordinating system for determining precedent, different jurisdictions will often apply the same rules in different ways. (Coles, sub. 7, p. 16)

Despite progress at the Federal and State level to improve consistency of food policy, there are still differences in the interpretation of regulations between those responsible for developing it and those responsible for enforcing it. ... As an example, ... In Brisbane, we can display fish fillets but not in Cairns where only the whole fish is permitted. ... The Belconnen store in the ACT has been directed to bag all naked bread due to their belief the bread is not adequately supervised. However in the ACT Gungahlin store, the same [Environmental Health Officer] has deemed no issue with their naked bread offering. (Coles, sub. 7, p. 17)

The NRA considered the inconsistency between jurisdictions warranted a national effort to deliver more uniform regulations:

In our initial submission ... we raised concerns about a complex and confusing web of regulations and rules which apply to different businesses depending on their different circumstances. We called for the Federal Government to establish an industry-led committee to simplify retail labelling laws, and to examine options for streamlining product technical and safety requirements. (sub. DR32, p. 7)

On the issue of inconsistencies at the local government level within jurisdictions, the Commission's previous work has found that many councils lack the resources needed to effectively apply state legislation (PC 2012c, p. 131). This finding suggests that if concerns about inconsistent regulation at the local government level are to be addressed, state governments will need to assume a greater role in building and maintaining local governments' regulatory capacity.

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## Other inconsistent regulations

While submissions concerned with differing regulations were predominantly focused on licensing requirements for the sale of liquor and tobacco, and product labelling and packaging and food safety laws, they also provided the Commission with examples of other regulations that differed across and within jurisdictions (box 8.4).

### Box 8.4 Regulations that differ between jurisdictions

#### *The sale of knives to minors*

Victoria, New South Wales, South Australia and the ACT ban the sale of knives to minors. However, regulations in the jurisdictions differ in the age above which retailers may sell a knife, type of knife banned, signage required, how the age of a minor might be determined at point of sale and penalties for a prohibited sale (Coles, sub. 7).

#### *Petrol price board standards*

Coles drew attention to differing state approaches to petrol price board regulation and record keeping, which has increased the red tape burden on petrol station operators (sub. 7).

#### *Shopping trolley management*

Coles noted differing local government approaches to trolley management:

... some individual Councils have chosen to introduce legislation imposing penalties or requiring investment by retailers in specific technology such as coin deposit systems ... We believe there should be flexibility in the local laws to allow for new technologies (such as wheel lock systems) to be installed that would benefit customers. There also needs to be a more consistent approach in terms of enforcement as approaches and fees can vary significantly. (sub. 7, p, 19)

#### *Workers compensation arrangements*

Gilmour's noted that workers' compensation arrangements vary across the separate states, and there is no uniformity in the type of reporting required for each state (sub. 11).

## Addressing inconsistencies is not a simple matter

Harmonisation is easier said than done, given the complexities in aligning different regulatory regimes. COAG processes have demonstrated that even relatively simple and uncontentious reforms can take a long time (for example, even a matter as seemingly as simple as wine bottle labelling was subject to discussions commencing in the 1990s leading up to the implementation of harmonised standards in 2009). In more complex areas, reforms have proven to be both highly contentious and elusive (for example in the area of occupational health and safety).

Moreover, moving from state-specific and differing regulation to new, nationally consistent requirements would not be unambiguously beneficial for all retailers.

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While the costs of moving to a new uniform set of requirements would generally fall on all retailers (box 8.5), the benefits of uniform requirements would only accrue to retailers operating in more than one jurisdiction. Uniform in-store signage and product safety requirements, for example, would allow retailers operating in more than one jurisdiction to benefit from the savings associated with having to comply with just one set of requirements rather than many. But retailers operating in only one jurisdiction would incur the added costs of having to comply with some new (uniform) requirements without any offsetting benefit (given that they were only subject to one set of requirements).

Accordingly, a move to more consistent regulations across jurisdictions could only be justified where the expected benefits of reform exceed the likely costs.

#### **Box 8.5      How consistency is introduced makes a difference**

If 'nationally consistent' regulation were introduced by developing a new set of regulation then retailers in all jurisdictions would face the added cost of complying with that new regulation.

However, if consistency were achieved by adopting model legislation of one jurisdiction, retailers operating in that jurisdiction would not incur any added costs of moving to comply with the new, 'nationally consistent' requirements.

Alternatively, it might be feasible to offer businesses the choice of opting into new, harmonised arrangements, with existing state or territory regulations as the default.

This two tiered or opt-in approach was not favoured by the NRA:

The NRA does not believe that a two-tiered or opt-in national approach to regulation would solve the issues of disparate state regulation in areas such as product, packaging and signage compliance. ... In our initial submission to this inquiry, we ... called for the Federal Government to establish an industry-led committee to simplify retail labelling laws, and to examine options for streamlining product technical and safety requirements. We believe these outcomes are preferable to a two-tier or opt-in national system. (sub. DR32, p. 7)

### **Government responses to concerns about excessive compliance costs**

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

- retail specific and generic regulation
- inconsistent regulation across jurisdictions
- licensing and registration obligations
- inadequate regulatory impact analysis (PC 2011).

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That report recommended:

Governments must prioritise efforts directed at the review and reform of existing regulations that are unnecessarily burdensome, and reduce regulatory inconsistency across jurisdictions where that affords net benefits to business and the community. Consideration also needs to be given to how existing quality control processes for new or amended regulation, including the application of Regulation Impact Statement processes, can be improved to minimise the risk that future regulation will impose unnecessary burdens. (PC 2011a, p. XLIII)

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

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

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

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

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

Consistent with its commitment to task the Commission to review, benchmark and report on regulatory issues, since 2011, the Government has requested the Commission to assess the impact of 17 of the 28 COAG business reforms (PC 2012b), benchmark regulatory impact analysis (PC 2012d), benchmark the role of local government as regulator (PC 2012c) and assess the burden of regulation on small business (PC 2013c) (box 8.6).

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### **Box 8.6 Commission reports on regulatory issues since 2011**

In 2012 the Commission assessed the impacts and benefits of 17 business regulation reforms including to product safety, occupational health and safety, and food. These reforms were agreed to by jurisdictions under COAG's National Partnership Agreement to Deliver a Seamless National Economy, which aimed to reduce the regulatory burden on firms operating in multiple jurisdictions. While the Commission assessed that there was the potential for reform to raise output and income in all jurisdictions, for firms that do not operate across state boundaries the gains from harmonisation could be eroded where additional transition and ongoing costs of reform exceeded the benefits. Overall, the Commission estimated the economywide benefits of fully implementing the reforms to be almost 0.5 per cent a year in increased output and around \$4 billion a year in lower business costs. The majority of gains could accrue by 2020.

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

In 2012, the Commission benchmarked the role of local government as regulators. That report noted business concerns about local government regulation including complex regulatory frameworks, jurisdictional overlaps and inconsistencies, and the inadequate resourcing of local governments. The report also noted that 'Significant progress has been made by all levels of government in implementing a consistent national approach for food safety'.

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

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

There is also evidence of efforts in this area at the state and territory government level.

The Premier of New South Wales indicated that state and federal governments are aware of the need to minimise the excessive burden of regulation. In the case of New South Wales, the Government is undertaking a review into unnecessary regulatory costs that affect the clothing retail sector (box 8.7). That review is expected to contribute to the New South Wales Government's overarching target to reduce red tape by 20 per cent by June 2015 (sub. DR30). In addition, the Independent Pricing and Regulatory Tribunal, at the behest of the New South Wales Government, is examining local government compliance and enforcement activity with the intent to provide recommendations that will reduce unnecessary regulatory burdens for business and the community. It released its draft report on this matter in May 2014 and is scheduled to deliver its final report to Government at the end of September 2014.

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**Box 8.7      New South Wales Government review of clothing retail regulatory costs**

There are more than 4000 clothing retail businesses in New South Wales, 99 per cent of which are small-to-medium enterprises. These businesses must identify and comply with regulations at the local, state and Australian government level.

To make it easier for clothing retailers to start up and operate a business, the New South Wales Government is undertaking a targeted review into the regulatory costs they face. The review is being delivered from the perspective of a business owner and is looking at all regulation associated with starting and running a clothing retail business. By capturing processes throughout the business lifecycle, and across all levels of government, the review will identify the cumulative regulatory burden businesses face and opportunities to reduce duplication and costs.

Consultations with retailers identified a number of regulatory costs, including:

- not being able to sell goods on restricted trading days
- the costs of complying with retail lease regulation, including lease preparation costs and the costs of complying with disclosing requirements
- under current regulations, clothing sales under \$1000 by an Australian business are subject to GST, whereas products bought from an overseas seller under that value are not.

Preliminary results from the review support the Productivity Commission's 2011 retail industry report findings that regulations at the federal, state, territory and local government levels hinder the industry's ability to respond efficiently to the demands and preferences of consumers.

*Source:* NSW Department of Premier and Cabinet, pers. comm., 26 August 2014.

The Victorian Government has committed to map regulatory requirements imposed on small businesses in exporting and food manufacturing and has developed online forms to reduce business red tape (Small Business Victoria, pers. comm., 12 May 2014). In addition, ALSA noted:

Victoria has established a Red Tape Commissioner and businesses can raise poor regulations with the Commissioner for investigation and independent review. (sub. DR31, p. 7)

Queensland has established the independent Office of Best Practice Regulation within the Queensland Competition Authority to help implement the Government's target of a 20 per cent reduction in the burden of regulation. The office has developed a framework for reducing the burden that includes a process for reviewing the stock of legislation and identifying priority areas for review. In addition, the Government has increased the rigour with which new regulation is made by enshrining the Regulatory Impact Statement system in legislation (Queensland Government, sub. DR37).

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

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#### FINDING 8.1

There is considerable variability in the regulations adopted by states and territories in relation to the retail sector to achieve broadly the same objective, for example in relation to signage, display and licensing of tobacco products and liquor. This increases compliance costs for retailers operating in multiple jurisdictions.

#### FINDING 8.2

In cases where state-specific regulations are well entrenched and involve considerable sunk costs for many retailers, regulatory harmonisation for firms that do not operate across state boundaries may produce minimal gains and impose net costs. The gains may principally be enjoyed by larger firms operating across Australia. For this reason, and given the large number of small single-state firms in the retail sector, it is important that governments subject reform and regulatory proposals to cost-benefit analysis. There may be more suitable reform options than harmonisation.

#### FINDING 8.3

Many councils lack the resources needed to effectively apply state and territory government legislation. Addressing concerns about unnecessary or inconsistent regulation at the local government level will require state and territory governments to assume a greater role in building and maintaining local government regulatory capacity.

## 8.3 Broader cost pressures

In addition to concerns about costs that particularly affect the retail industry, participants were concerned about costs that also affect other industries.

### High and rising utility charges

Submissions highlighted a number of issues in relation to the costs retailers face for utilities services, including the general level of energy prices and inefficient water delivery charges:

Electricity is a significant input into many Australian businesses. It represents an unavoidable cost of doing business due to our reliance on energy to produce goods and services for the domestic market and export. (Swimming Pool And Spa Alliance, sub. 5, p. 8)

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The Government should ... work with the states to maximise efficiency of the electricity supply chain – reducing real costs for businesses and consumers and providing a long term boost to the retail sector. (NRA, sub. 18, pp. 8–9)

Small and medium retailers have cited exorbitant increases in energy supply costs as a key cost of doing business. Electricity prices have doubled on average for business over the past seven years ... (CCIQ, sub. DR29, p. 5)

... energy will continue to represent a significant cost of liquor retailing. (ALSA, sub. DR31, p. 5)

Another area of significant complaint by the SBDC's clients is the cost of electricity supply. (Small Business Development Corporation, sub. DR36, p. 6)

SA Water bases its water pricing on the capital value of land rather than actual water usage (although this is presently being reviewed). (Shopping Centre Council of Australia, sub. 17, p. 9)

The Commission examined electricity pricing as part of its 2013 inquiry into *Electricity Network Regulatory Frameworks*. The findings of that inquiry — that average electricity prices across the network rose by about 70 per cent in real terms from June 2007 to December 2012 — support the concerns expressed by participants. It also found spiralling network costs in most states are the main contributor to those increases, partly driven by inefficiencies in the industry and flaws in the regulatory environment. Moreover, reform to address these flaws has been painfully slow (PC 2013b, pp. 2, 10).

## **Compliance costs for paid parental leave and superannuation**

The Council of Small Business of Australia (COSBOA) noted that various regulatory arrangements imposed unnecessary compliance costs on small retail businesses — and highlighted those associated with paid parental leave and superannuation arrangements.

### **Paid parental leave**

COSBOA raised a number of concerns about the compliance cost associated with the current paid parental leave scheme (sub. DR20, p. 7), with the bottom line being that the current process for payment of parental leave imposes excessive compliance costs on businesses.

Concerns about the role of the employer and associated compliance costs were considered by the Commission in its inquiry and subsequent recommendations on paid parental leave (PC 2009a). Moreover, prior to the Government's introduction of the scheme in 2011, it undertook extensive stakeholder consultations, which led to significant changes to the design of the scheme in order to lessen the compliance burden on employers (Department of Social Services 2014, p. 95).



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In addition, the two main accounting packages used by small businesses (MYOB and Quickbooks) provide a simple, thorough set of instructions on how to set up paid parental leave arrangements. Both packages also provide a customer support service that assists package users to institute the necessary adjustments to their systems.

The Department of Social Security reviewed the scheme in 2014. One aspect of that review examined the compliance costs the scheme imposed on employers. On this aspect, the review found the employer role is generally operating smoothly, with 74 per cent of Phase 2 employers and 81 per cent of Phase 3 employers reporting that the scheme had been easy to implement in their organisation. Moreover, the evaluation found no significant differences between different sized businesses (Department of Social Services 2014, pp. 101–2). As a result of its evaluation, the department concluded:

Overall employers appear to have taken on the role without major financial cost increases. The PPL [Paid Parental Leave] evaluation found most employers felt the costs of implementing the PPL scheme were minimal. (DSS 2014, p. 104)

## Superannuation arrangements

COSBOA was also critical of the level of compliance costs imposed on small businesses as a result of the current superannuation arrangements (sub. DR20, p. 6).

The Australian Government has introduced measures to address business concerns. The most significant of these are the development of the Small Business Superannuation Clearing House (box 8.8) and a number of measures collectively known as SuperStream (introduced to make the processing of everyday superannuation transactions easier, cheaper and faster).

### **Box 8.8      Small Business Superannuation Clearing House**

The clearing house is a free service available to employers with 19 or fewer employees. The service allows employers to make one single secure electronic payment for all their employees, minimising the time and paperwork involved in allocating contributions to numerous funds.

Since commencement of registrations on 24 May 2010, 58 304 employers have registered to use the service.

Responsibility for the clearing house transferred to the Australian Taxation Office on 1 April 2014.

Treasury consultations with industry in 2014 indicate that users are generally happy with the clearing house service, it is easy to use and they would recommend it to other eligible employers.

*Source:* Treasury, pers. comm., July 2014.

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## **Taxes and rates that are excessive**

ANRA, using PricewaterhouseCoopers' research, claimed that Australian retailers face a high number of taxes when compared to other Australian industry groups (sub. 16, p. 15). In addition, Woolworths and the Shopping Centre Council of Australia argued some state and council taxes and charges they face are excessive:

Costs imposed by fees and charges ... land tax, council rates and service charges in South Australia are relatively high compared to other jurisdictions. ... For a parcel of land valued at \$20 million, the tax payable in South Australia is over \$700 000. Victoria would levy just over \$400 000 while Western Australia would levy less than \$300 000. (sub. 13, p. 6)

The Shopping Centre Council of Australia (sub. DR27, p. 6) drew attention to the growth in the level of statutory charges (for example, council rates, water rates, land tax), noting that from 2009 to 2013, these increased by around 15 per cent. As well, it noted:

We provided evidence in our previous submission about the impact and volatility of rate gouging for six of our members' properties (in NSW). The table ... outlines that even where land valuation has decreased (which is reflected in lower land tax), council rates increased in the same period, which generally reflects a specific decision of that council to increase the rate which applies to the shopping centres and its retailers. (sub. DR27, p. 10)

This 'rate gouging', it argued, was the result of councils preferring to cross subsidise residential owners:

Council rates have become a major area of concern in recent years mainly due to the invention by Australia's local councils of dubious reasons to impose higher rates on shopping centres ... we are therefore left in the hands of an irrational council which will gladly increase commercial property rates in order to maintain lower residential rates. (sub. 17, p. 9)

However, the task of assessing the appropriateness of taxes and charges applicable to the retail industry is beyond the scope of this study and needs to be examined in a broader context where the interests of all affected industries can be considered.

## **8.4 Other concerns**

Although not part of the costs of doing business as defined by this study, participants also raised concerns about regulations that increased the cost of their goods sold (tariffs and parallel import restrictions) and regulations that adversely affected demand for their products (the LVT for applying taxes and charges on imports and shortcomings in the Tourist Reimbursement Scheme for GST).

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## **Regulations that increase the cost of local retailers' goods sold**

### **Tariffs and preferential tariff agreements**

Some participants noted that tariffs artificially inflate domestic retailers' costs through, for example, the import duties and customs charges paid. The Commission has examined this issue extensively in the past, drawing attention to the net gains available from key reforms (see, for example, PC (2009b, 2011a)).

Tariffs were also problematic for some retailers because, they argued, their offshore competitors could circumvent them by setting up distribution centres in countries through which they could source imports at significantly lower tariffs than Australia and with which Australia has preferential trade agreements. As a result, they claimed, these online competitors could deliver items to Australian consumers (imported through those intermediary countries) that were subject to a lower overall rate of duty than an Australian retailer would incur by importing it directly and onselling to a domestic consumer.

A review of the Australian taxation system would provide an opportunity for the Government to reconsider the net costs of tariffs to businesses and consumers, including the compliance costs to businesses and consumers arising from complex rules of origin, and the revenue trade-offs required with the removal of tariffs.

### **Parallel import restrictions**

ANRA raised the issue of parallel importation regulations, which restrict imports into Australia of material subject to copyright, such as books, computer software and DVDs.

These restrictions mean local retailers are forced to buy products from the local publisher only and are not permitted to import legitimate products produced offshore. This limits the competition in the wholesale market for these products, ultimately driving up retailers' wholesale costs and leading to local consumers paying more than their overseas counterparts. (sub. 16, p. 18)

The Commission's 2011 report identified that copyright laws can be used to prevent the resale of parallel imported goods in certain circumstances, and recommended:

The Australian Government should request the Australian Law Reform Commission, as part of its forthcoming Copyright Inquiry, to examine whether the costs to the community outweigh the benefits in relation to the parallel import restrictions in the Copyright Act 1968, which prevent retailers from importing and selling clothes or other goods which embody decorative graphic images sold with the copyright owner's permission in another market. (PC 2011a, p. XL)

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

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## Regulations that reduce demand for local retailers' products

### Low value threshold

Goods imported into Australia (including those purchased online) with a value at or below \$1000 do not attract customs duty, GST, Customs and Australian Quarantine and Inspection Services charges, nor the requirement to complete a full import declaration. Alcohol and tobacco are exceptions to the threshold and the full range of taxes and charges must be paid on any imports of these goods.

THE ICONIC argued that the LVT severely disadvantaged their business:

... the importation of apparel and footwear attracts duties of 10 per cent and 15 per cent respectively. THE ICONIC competes directly with overseas business, such as ASOS, and the fashion industry as a whole is increasingly moving to global price harmonisation. As a consequence, THE ICONIC must itself absorb the cost of importation duties — having limited ability to pass on the cost to the consumer. The issue is naturally compounded by the tax-free threshold applicable to the Goods and Services Tax ... (pers. comm., 21 July 2014)

While the NRA noted:

Together, these exemptions [from duty and GST] can represent a cost-advantage of up to 25 per cent over a comparable product sold by an Australian-based business — regardless of where products are manufactured or sourced.

In our experience, large overseas-based retail chains have become adept at ensuring their sales to Australia remain under this threshold. Where necessary they may break a large purchase up into smaller bundles, each of which sits under the \$1000 cap and therefore qualifies for the exemptions. (sub. DR32, p. 4)

ANRA (sub. 16, pp. 17–18) also argued that the current level for the LVT was severely damaging to the sales for Australian retailers. It cited Ernst and Young estimates that if the LVT were lowered to \$20 then by 2020 over \$9 billion in retail sales would shift back to Australian traditional and online retailers from foreign retailers. Accordingly, it called for a much lower threshold to address their concerns.

The Commission examined this issue in its 2011 inquiry. That inquiry found that the LVT of \$1000 distorts consumer choice in favour of online retailers. The Commission (PC 2011a) recommended:

There are strong in-principle grounds for the low value threshold (LVT) exemption for GST and duty on imported goods to be lowered significantly, to promote tax neutrality with domestic sales. However, the Government should not proceed to lower the LVT unless it can be demonstrated that it is cost effective to do so. The cost of raising the additional revenue should be at least broadly comparable to the cost of raising other taxes, and ideally the efficiency gains from reducing the non-neutrality should outweigh the additional costs of revenue collection (recommendation 7.1).

The Government should establish a taskforce charged with investigating new approaches to the processing of low value imported parcels, particularly those in the international mail stream,

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and recommending a new process which would deliver significant improvements and efficiencies in handling. The taskforce should comprise independent members, with the Australian Customs and Border Protection Service (Customs), the Australian Quarantine and Inspection Service (AQIS), Australia Post and the Conference of Asia Pacific Express Carriers providing advice. The terms of reference should outline the criteria that any new system must satisfy including: minimising the costs of processing and delivery delays, streamlining the assessment of Customs Duty, user pays, and without compromise to the border protection functions of Customs and AQIS. This review should report to Government in 2012 and propose an expeditious timeframe for its proposed changes.

Once an improved international parcels process has been designed, the Australian Government should reassess the extent to which the LVT could be lowered while still remaining effective (recommendation 7.2).

In response, the Government noted recommendation 7.1, agreed to recommendation 7.2 and advised that it would establish a Low Value Parcel Processing Taskforce to provide a blueprint for reform of the low value import processing system, with costed alternatives, for the Government's consideration (Australian Government 2011).

The Taskforce reported in July 2012 and recommended an approach to handling and administering low value goods, including revenue implications, however due to data limitations advised that this did not constitute a business case (Low Value Parcel Processing Taskforce 2012). In its interim response to the Taskforce's report in December 2012, the Australian Government advised that further work on business cases, costing and implementation plans was required before any decision on changing the LVT (Australian Government 2012).

In November 2013, the Australian Government Treasurer commissioned a working group of state and Commonwealth Treasuries to finalise proposals for lowering the threshold (Baird 2013). In May 2014, the NSW Treasurer stated that jurisdictions were evaluating a business case to lower the threshold (Bita 2014).

The states and territories were to advise the Australian Government of their preferred proposal at the meeting of the Council of Federal Financial Relations in September 2014. However, they were unable to agree on a business case to present at that meeting.

### Tourist Refund Scheme

Austrade drew attention to the Tourist Refund Scheme (whereby tourists are eligible for reimbursement of the GST component of their purchases, claimable at the point of their departure). It noted the scheme is not effectively marketed to tourists and only 3.6 per cent of all departing passengers make claims (sub. DR34, p. 3). Austrade suggested various options to make the scheme more well-known and to facilitate reimbursement of GST while tourists are still in Australia.



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## A Public Consultation

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

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

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

The Commission released an interim report on 6 June 2014 and received a further 23 written submissions. These are listed in table A.1 with the prefix 'DR'.

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

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

The Commission thanks all those who have contributed to this study.

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**Table A.1 Submissions received**

<i>Participant</i>	<i>Submission No</i>
Austrade	DR34
Australia Post	DR38
Australian Automotive Aftermarket Association	DR21, DR39
Australian Council of Trade Unions	DR28
Australian Liquor Stores Association	DR31
Australian National Retailers Association	16, DR25
Australia Post	DR38
Australian Retailers Association	14
Australian Sporting Goods Association	10
Bicycle Industries Australia	8
Brohier, Peter	DR42
Business SA	DR24
Chamber of Commerce and Industry Queensland	DR29
City of Melbourne	3
Coles	7
Council of Small Business of Australia	DR20
Frontline Hobbies	4
Gilmour's	11
Kepnock Residents' Action Group	DR35 <sup>a</sup> , DR40, DR41
Large Format Retail Association	19
Margetts, Dr Diane (Dee)	1
Master Grocers Australia / Liquor Retailers Australia	DR26
National Retail Association	18, DR32
Office of the Australian Small Business Commissioner	DR22
Pharmacy Guild of Australia	12, DR23
Premier of New South Wales	DR30
Queensland Government	DR37
Shop, Distributive and Allied Employees' Association	6
Shopping Centre Council of Australia	17, DR27, DR33
Small Business Development Corporation	9, DR36
Supply Chain and Logistics Association of Australia	15
Swimming Pool and Spa Alliance	5
Western Australian Independent Grocers Association	2
Woolworths	13

<sup>a</sup> In confidence material omitted.

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**Table A.2      Meetings**

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*Participant*

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ALDI  
Australian Centre for Retail Studies, Monash University  
Australian Local Government Association  
Australian National Retailers Association  
Australian Retail Association  
Bunnings and Officeworks  
Citibank  
Coles  
Costco  
Council of Small Business of Australia  
Department of Commerce (WA)  
Department of Premier and Cabinet (NSW)  
Department of Premier and Cabinet (Vic)  
Department of State Development, Business and Innovation (Vic)  
Department of Sustainability and Environment (Vic)  
Department of the Premier and Cabinet (Qld)  
Department of the Premier and Cabinet (SA)  
Department of the Prime Minister and Cabinet  
Department of Transport, Planning and Local Infrastructure (Vic)  
Economic Development Board of South Australia  
Ernst & Young  
KPMG  
Queensland Competition Authority  
Reserve Bank of Australia  
Shopping Centre Council of Australia  
Small Business Victoria  
Stockland  
THE ICONIC  
The Treasury  
UBS  
Western Australian Department of Commerce  
Westfield  
Woolworths

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**Table A.3      Supplementary information received**

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*Government Agency*

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Attorney-General's Department

Australian Bureau of Statistics

Department of Business, Northern Territory

Department of Commerce, Western Australia

Department of Lands, Planning and the Environment, Northern Territory

Department of Planning, Transport and Infrastructure, South Australia

Department of Planning, Western Australia

Department of State Development, Infrastructure and Planning, Queensland

Department of State Development, Business and Innovation, Victoria

Department of Treasury and Finance, Tasmania

Environment and Sustainable Development Directorate, Australian Capital Territory

NSW Industrial Relations

Office of the Minister of Planning, Victoria

Office of the Small Business Commissioner, New South Wales

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