



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

# Economic Structure and Performance of the Australian Retail Industry

Productivity Commission  
Inquiry Report

No. 56, 4 November 2011

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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.

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4 November 2011

The Hon Bill Shorten MP  
Assistant Treasurer  
Parliament House  
CANBERRA ACT 2600

Dear Assistant Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, I have pleasure in submitting to you the Commission's final report into Economic Structure and Performance of the Australian Retail Industry.

Yours sincerely

A handwritten signature in cursive script, appearing to read 'P Weickhardt'.

Philip Weickhardt  
Presiding Commissioner

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## Terms of reference

I, Bill Shorten, Assistant Treasurer and Minister for Financial Services and Superannuation, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998* hereby request that the Productivity Commission undertake an inquiry into the implications of globalisation for the Australian retail industry, with a view to informing the Government on whether current policy settings are appropriate in this environment. The Commission will commence the inquiry in February 2011 and report in November 2011. The Commission will hold hearings for the purpose of this inquiry.

### Scope of the Inquiry

The Commission is requested to examine:

1. The current structure, performance and efficiency of the retail sector and impediments to its contribution to the Australian economy;
2. The drivers of structural change in the retail industry, including globalisation, increasing household and business access to the digital economy, cost structures of the domestic retail industry, employment structure, the exchange rate and structural change driven by the resources boom;
3. The broader issues which are contributing to an increase in online purchasing by Australian consumers and the role of online purchasing in providing consumers with greater choice, access and convenience;
4. The sustainability and appropriateness of the current indirect tax arrangements in this environment, including the impact on Commonwealth and State and Territory budgets, and the extent to which technology could reduce the administrative costs of collecting indirect taxes and duty on imported goods; and
5. Any other regulatory or policy issues which impact on structural change in the sector. The Commission is to provide both a draft and a final report, and the reports will be published. The government will consider the Commission's recommendations, and its response will be announced as soon as possible after the receipt of the Commission's report.

Bill Shorten

Assistant Treasurer

[Received 3 February 2011]

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# Contents

<b>Terms of reference</b>	<b>IV</b>
<b>Abbreviations</b>	<b>IX</b>
<b>Overview</b>	<b>XIII</b>
<b>Key points</b>	<b>XIV</b>
<b>Recommendations</b>	<b>XL</b>
<b>1 About the inquiry</b>	<b>1</b>
1.1 What the Commission has been asked to do	1
1.2 Scope of the inquiry	2
1.3 The Commission’s approach	4
1.4 A guide to the report	5
<b>2 The role and development of Australian retail</b>	<b>7</b>
2.1 What is the role of retail?	7
2.2 How has the retail industry developed in Australia?	9
<b>3 The structure and performance of the retail industry</b>	<b>27</b>
3.1 A snapshot of the retail industry	29
3.2 Market structure in retail	35
3.3 Indicators of retail performance	40
3.4 Conclusion	70
<b>4 Trends and issues related to online retailing</b>	<b>73</b>
4.1 The development of e-commerce and online retailing	74
4.2 Online share of retail sales	82
4.3 Estimates for online retail share of total retail sales in the United Kingdom and the United States	90
4.4 What is driving online sales?	93
4.5 Characteristics of online purchasing	95
4.6 The slow emergence of online grocery shopping	101

---

4.7	Rapid growth in m-commerce	102
4.8	Why has Australia lagged online sales of other countries?	103
4.9	Constraints to online growth	106
<b>5</b>	<b>Consumer protection</b>	<b>115</b>
5.1	Australia's consumer protection laws and online retailing	116
5.2	Product safety and warranty issues in online retailing	119
5.3	Online transaction security and protection against fraud	131
5.4	Search engines	133
<b>6</b>	<b>Retail price differences</b>	<b>139</b>
6.1	The Commission's retail price comparisons	141
6.2	Factors influencing retail prices	144
6.3	Conclusion	168
<b>7</b>	<b>Appropriateness of current indirect tax arrangements</b>	<b>169</b>
7.1	Low value importation threshold	170
7.2	The Australian threshold	172
7.3	Overseas indirect tax arrangements	177
7.4	Impact of the threshold on revenue	178
7.5	Processing of parcels entering Australia	182
7.6	Economic principles	188
7.7	Impact of the threshold arrangements	191
7.8	Changing the threshold	199
7.9	Options for reforming processes	203
7.10	Overseas online purchases of intangibles	209
7.11	The way forward	210
<b>8</b>	<b>Planning and zoning regulation</b>	<b>215</b>
8.1	How planning and zoning affects retail in Australia	216
8.2	The impact of planning and zoning regulations on retail competition — overseas evidence	221
8.3	Other impacts of planning and zoning regulations on the retail industry — overseas evidence	225

---

8.4	The Australian experience with planning and zoning restrictions on competition	233
8.5	Planning regulation and compliance costs	256
<b>9</b>	<b>Retail tenancy leases</b>	<b>259</b>
9.1	The market for retail tenancy leases	260
9.2	What are retail tenancy leases and how are they regulated?	263
9.3	Recent regulation review and reform activity	264
9.4	COAG retail tenancy reform activity	265
9.5	The impact of planning and zoning on the market for retail tenancy leases	270
<b>10</b>	<b>Retail trading hours regulation</b>	<b>275</b>
10.1	Why are trading hours regulated?	276
10.2	What are the costs associated with regulation?	278
10.3	Changing social patterns have led to more liberalised trading hours in Australia	280
10.4	Are there benefits to be gained from deregulating shopping hours further in Australia?	292
10.5	Should retail trading hours be fully deregulated?	310
<b>11</b>	<b>Workplace relations regulation</b>	<b>313</b>
11.1	Introduction	314
11.2	Industrial relations laws and institutional arrangements	316
11.3	Setting pay and conditions in retail	320
11.4	Wages and earnings outcomes and trends	327
11.5	Concerns about awards and labour costs	330
11.6	Workplace flexibility	346
11.7	Conclusion	370
<b>12</b>	<b>Employment, skills and training</b>	<b>375</b>
12.1	Employment	376
12.2	Training	392
12.3	Are labour shortages and skill levels affecting the retail industry?	398
12.4	Conclusion	402

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<b>13 Other regulatory burdens</b>	<b>405</b>
13.1 Introduction	406
13.2 Concerns raised with this review	406
13.3 Existing processes for the identification and reform of unnecessary regulatory burdens	414
13.4 Conclusion	416
<b>A Consultation</b>	<b>421</b>
<b>References</b>	<b>433</b>

The following appendices are referred to in the chapters, but are not reproduced in the report. They are available on the inquiry website:  
[www.pc.gov.au/projects/inquiry/retail-industry](http://www.pc.gov.au/projects/inquiry/retail-industry)

- B Retail tenancy legislative activity by state**
- C Wages and earnings outcomes and trends**
- D Flexibility provisions in enterprise agreements**
- E The Commission's retail price comparisons**
- F Foreign indirect tax arrangements**
- G Retail productivity**
- H Impacts of reducing the LVT**

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# Abbreviations

AAWI	Average annualised wage increases
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACL	Australian Consumer Law
ACMA	Australian Communications and Media Authority
ACTU	Australian Council of Trade Unions
AiG	Australian Industry Group
AIRC	Australian Industrial Relations Commission
AMA	Australian Music Association
ANRA	Australian National Retailers Association
ANZSIC	Australian and New Zealand Standard Industrial Classification
APEC	Asia-Pacific Economic Cooperation
AQIS	Australian Quarantine and Inspection Service
ARA	Australian Retailers Association
ASIC	Australian Securities and Investment Commission
AWA	Australian Workplace Agreements
AWE	Average weekly earnings
AWOTE	Average weekly ordinary time earnings
BGRA	Bulky Goods Retailers Association
BLS	Bureau of Labor Statistics (US)

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BRCWG	Business Regulation and Competition Working Group
B2B	Business to business
B2C	Business to consumer
CAPEC	Conference of Asia Pacific Express Carriers
COAG	Council of Australian Governments
COSBOA	Council of Small Business Organisations of Australia
DEEWR	Department of Education, Employment and Workplace Relations (Australian Government)
DSAA	Direct Selling Association of Australia
EBIT	Earnings before interest and taxes
EFTPOS	Electronic funds transfer at point of sale
EU KLEMS	European Union capital, labour, energy, material and service inputs
FAI	Fair Imports Alliance
FID	Full import declaration
FW Act	Fair Work Act
FWA	Fair Work Australia
FWO	Fair Work Ombudsman
GFC	Global Financial Crisis
GVA	Gross Value Added
HFCE	Household Final Consumption Expenditure
ICOMP	Initiative for a Competitive Online Marketplace
ICPEN	International Consumer Protection Enforcement Network
IPC	International Processing Charge
ICS	Integrated Customs System

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ICT	Information and communications technology
IFA	Individual Flexibility Arrangement
ISIC	International Standard Industrial Classification of all economic activities
LVT	Low Value Threshold
MFP	Multi Factor Productivity
NAPSA	Notional agreements preserving state awards
NCVER	National Centre for Vocational Education Research
NES	National Employment Standards
NRA	National Retail Association
NRTWG	National Retail Tenancy Working Group
OECD	Organisation of Economic Cooperation and Development
PC	Productivity Commission
PPP	Purchasing power parity
QIRC	Queensland Industrial Relations Commission
RBA	Reserve Bank of Australia
RTAWA	Retail Traders' Association of Western Australia
SAC	Self Assessed Clearance
SME	Small and medium enterprises
SDA	Shop, Distributive & Allied Employees' Association
TAFE	Technical and Further Education
TGA	Therapeutic Goods Administration
UPU	Universal Postal Union
US FTC	United States Federal Trade Commission



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# OVERVIEW

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## Key points

- There are almost 140 000 retail businesses in Australia, accounting for 4.1 per cent of GDP and 10.7 per cent of employment.
- The retail industry exhibits great diversity by: size of business, region, retail format, competition within sectors and in the nature of goods sold. Both current trading conditions and longer term trends are challenging. Retail sales *growth* has trended down over the past half decade as consumers save more of their rising incomes and their spending is increasingly directed towards a range of non-retail services.
- The retail industry has met many competitive challenges in the past. Online retailing and the entry of new innovative global retailers are just the latest. The intensified competition is good for consumers, but is challenging for the industry which, as a whole, does not compare favourably in terms of productivity with many overseas countries. And the productivity gap appears to have widened over time.
- Australia also appears to lag a number of comparable countries in its development of online retailing. The Commission's best estimate is that online retailing represents 6 per cent of total Australian retail sales — made up of 4 per cent domestic online (\$8.4 billion) and 2 per cent from overseas (\$4.2 billion). In some other countries, online sales figures are higher and set to grow further, as will also happen here.
- Retailers operate under several regulatory regimes that restrict their competitiveness and ability to innovate. Major restrictions which need to be addressed are:
  - planning and zoning regulations which are complex, excessively prescriptive, and often anticompetitive
  - trading hours regulations which restrict the industry's ability to adapt and compete with online competitors and provide the convenience that consumers want.
- Workplace relations regulations may not provide sufficient workplace flexibility to facilitate the adoption of best practice productivity measures in the retail industry, and require examination in the reviews scheduled in 2012.
- The current level of the low value threshold (LVT) for exemption from GST and duty on imports of \$1000 is judged to be a minor part of the competitive disadvantage faced by retailers. But there are strong in principle grounds for the LVT to be lowered significantly, to promote tax neutrality with domestic sales. However, the Government should not proceed to lower the LVT until it is cost effective to do so.
- The Government should establish a taskforce charged with investigating new approaches to the processing of low value imported parcels, particularly those in the international mail stream, and recommending a new process which would deliver significant improvements and efficiencies in handling without creating delivery delays or other compliance difficulties for importers and consumers.
- Once an improved international parcels process has been designed, the Government should reassess the extent to which the LVT could be lowered while still remaining cost effective — the costs of raising this additional revenue should be at least broadly comparable to the costs of raising other taxes.

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# Overview

Retailers are intermediaries between producers and consumers. Their efficient and effective operation is important to ensure consumers have access to the widest choice of goods at the best prices and receive service consistent with their preferences.

The Government asked the Commission to undertake an inquiry into the implications of globalisation for the retail industry and the sustainability and appropriateness of current indirect taxation arrangements in this environment. This includes addressing the structure and performance of the retail industry and impediments to its contribution to the Australian economy. As well, the Commission is to address any other regulatory or policy issues which impact on structural change in the industry.

The Ministerial Joint Media Statement announcing this inquiry highlighted the importance of online retailing for the future of the industry. It noted that online retailing is here to stay and that the Commission will consider the role it plays in providing consumers with greater choice, access and convenience.

This requires an understanding of the role of online retailing, but also of the other drivers of structural change in the retail industry including: globalisation; cost structures of the domestic retail industry; employment characteristics; and competition within the industry. The regulatory landscape within which the industry operates — such as planning and zoning, trading hours and workplace relations regulations — also has a role in shaping its structure and performance.

## **Background on the retail industry**

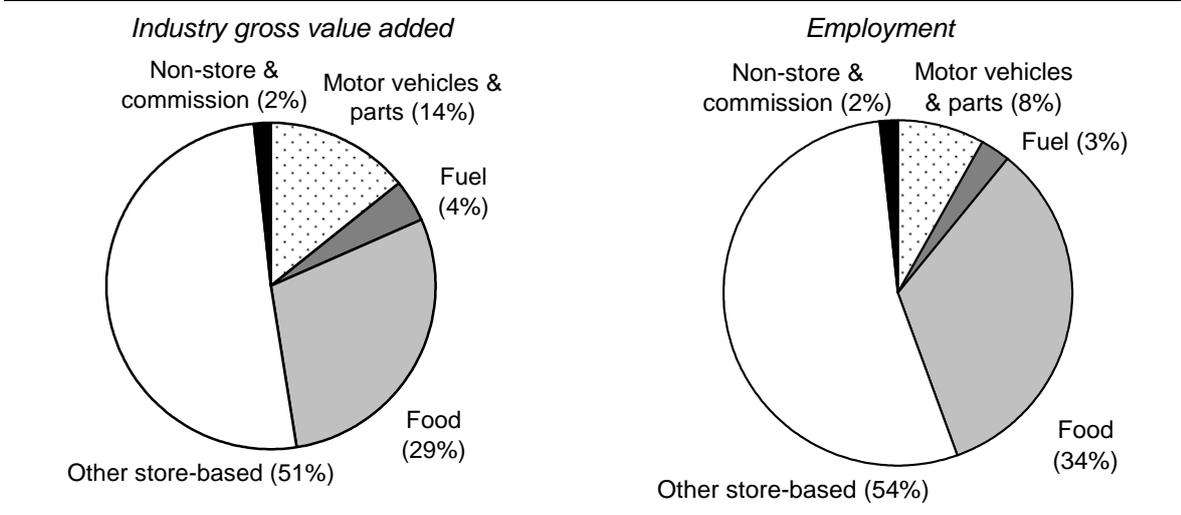
Retailers do more than simply sell goods. The retail industry is a service industry and has many roles — it introduces consumers to new products and assists them to assess products and compare prices. It enables consumers to buy goods at convenient times and locations and in quantities they find appropriate to their needs. It also can provide a range of ancillary services such as arranging financial services or providing after sales services.

There are almost 140 000 retail businesses in Australia and, with about 1.2 million people or 10.7 per cent of the total working population employed in the industry, it is one of Australia’s largest employers. Reflecting this, the retail industry also makes a significant contribution to economic output, generating \$53 billion or 4.1 per cent of GDP in 2009-10. However, its share of GDP has been declining slightly over time reflecting slower growth than in other parts of the economy.

The retail industry is diverse — it covers a number of sectors (figure 1) which exhibit differing characteristics. The bulk of the industry consists of what is termed in ABS statistics *other store-based retailing*. This comprises department stores and speciality stores such as furniture, electrical and electronic goods and clothing and footwear retailers, among many others.

In the initial stages of this inquiry, the Commission indicated that it would exclude from general consideration the fuel and motor vehicle retailing sectors, as the terms of reference appear less applicable to those sectors.

**Figure 1 Contributions to retail industry output and employment, 2009-10**



In 2009-10, sales for the retail sectors which are the main focus of this inquiry are shown in table 1. The industry is diverse by sector, by region, and by size of businesses and exposure to competition. The retail workforce has relatively low skill levels and is relatively youthful with a high share of females. The workforce is characterised by high levels of part time and casual working arrangements and high rates of employment turnover.

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**Table 1 Retail sales, 2010**

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	<i>Sales</i>	<i>Share of total</i>
	\$ billions	%
Food	96.6	44.9
Household goods	42.8	19.9
Clothing, footwear and personal accessory	19.3	9.0
Department stores	18.6	8.7
Other	33.5	15.6
Online offshore (PC estimate)	4.2	2.0
<b>Total</b>	<b>215.0</b>	<b>100.0</b>
<i>Online domestic (PC estimate)</i>	<i>8.4</i>	<i>4.0</i>

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There has been substantial commentary concerning the current difficult environment for the retail industry. A focus on recent sales performance, however, risks detracting from consideration of important longer term developments.

The growth rate of retail sales has generally trended down over the past two decades, due to long-term or structural changes in the economy and consumer behaviour. These changes are lessening the significance of spending on retail goods in consumer budgets. The share of retail spending in overall consumer spending fell from over 35 per cent in the early 1980s to just under 30 per cent currently. Consumers are increasingly spending a greater share of their rising incomes on services, such as financial services, property and accommodation, education, travel and hospitality.

A major reason why consumers are spending a smaller share of their incomes on goods sold by retailers is because many retail goods have become cheaper. More recently, the appreciation of the Australian dollar has also placed further downward pressure on the prices of imported goods. While this trend spells a challenge for some retailers, consumers are better off — they are buying more retail goods, but at relatively lower prices, and are able to use the additional remaining income to satisfy other preferences, such as for consumer services or savings.

The long-term downward trend in the growth rate of retail sales has been accentuated in recent years by the growing savings rate of households. In past periods, the willingness of consumers to increase their overall spending at a rate faster than their growth in disposable income compensated for the impact of the falling share of consumer expenditure directed towards retail goods — this is currently not happening. Over the longer term, the main drivers of retail sales growth have been broader factors affecting the economy, in particular increasing disposable incomes and population growth. This longer term decline in sales growth has been reinforced in recent years by cyclical or short-term market weakness — sales during 2011 are especially soft.

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## Background for policy considerations

### Retail is a diverse industry

Given the diversity of the retail industry, it would be impossible in a study of this nature to carry out a comprehensive competition analysis covering all retail sectors and all regions. However, from a policy standpoint this is not a critical limitation because any competition policy issues that arise from an examination of this industry are not dependent on the outcome of any such sector-by-sector analysis — and should be acted upon in any case, as discussed below.

Concern has been expressed about sectors of the retail industry such as food and grocery retailing, which have high levels of market concentration by international standards. This is true of many sectors of the Australian economy, due in part to the comparatively small domestic market. Market concentration alone does not provide much guidance to the competitiveness of a market. What matters more are barriers to entry and, associated with these, the extent of market contestability. There are many examples in Australia of highly concentrated markets where barriers to entry are low, exposure to international trade is high and competition is intense.

Barriers to entry for retail are unlikely to be substantial in most sectors. One way of assessing this is to examine the proportion of businesses which enter and exit the industry each year. The rates of entry (13.4 per cent) and exit (15.8 per cent) in retail in 2008-09 are broadly equivalent to those for all Australian industry. While the rate of business exits and new entrants by number alone may not indicate the competitive significance of such new entrants, these numbers do suggest that retailing is a dynamic and contestable market overall. Moreover, some new entrants are significant competitors bringing with them new business models and increased choice for consumers. Indeed, a number of recent new entrants — such as Aldi and Costco in the food and grocery sector and Zara and Gap in the clothing sector — are major overseas retailers.

Previous analysis by the Australian Competition and Consumer Commission (ACCC) of the food and grocery sector made a number of recommendations to strengthen competition in the sector, including in relation to planning and zoning regulations. For many parts of the retail market, location is critical to the level of effective competition. This is certainly true in the food and grocery sector. As a result, the ACCC recommended that appropriate levels of government should take into account potential impacts that might reduce competition when they develop planning and zoning regulations and make planning decisions in respect of individual developments.

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Technological innovation and the relative ease with which new online businesses can be established have also substantially lowered barriers to entry and hence added considerably to the competitive environment for retailers. Competitors are today not just down the street or in the next suburb, but include easily-accessed suppliers across Australia and overseas.

As a generalisation, smaller, non-perishable and easily shipped goods lend themselves to online retailing and this is where the largest growth of domestic and overseas online competition is occurring — this includes, for example, books, CDs/DVDs, apparel, bike parts, cameras and accessories. Accordingly, the competitive pressure faced by domestic retailers from online shopping varies considerably depending on the nature of the goods sold. Further, the competitive impact of online retailing is not confined to the market share of these retailers — online retailers can, and do, have a more pervasive impact on the prices offered by bricks and mortar retailers.

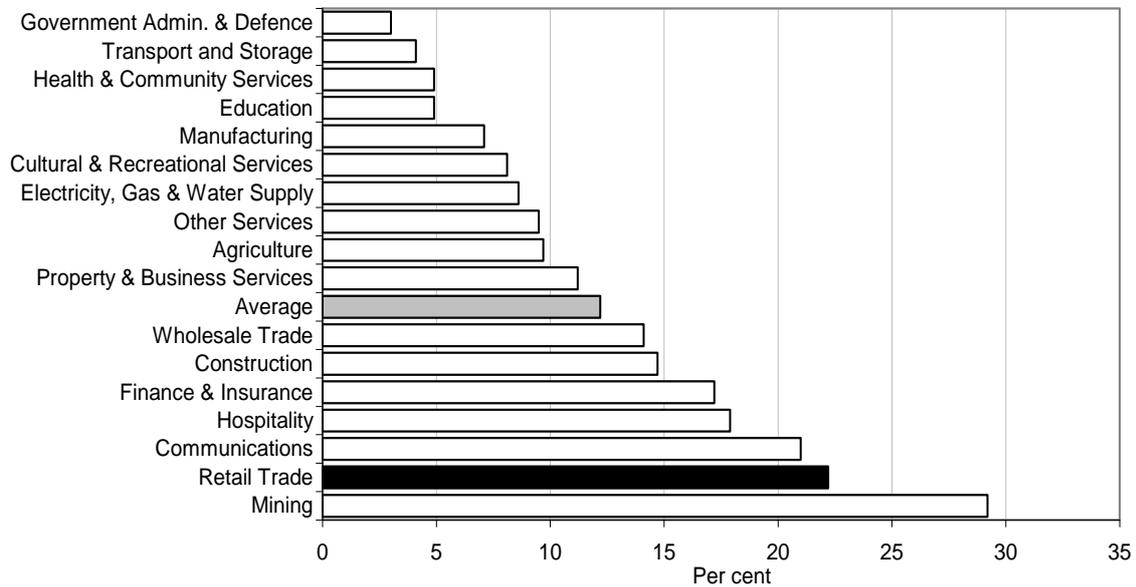
### **Indicators of performance of the retail industry — profits and productivity**

Whilst the factors mentioned above suggest that barriers to entry may be quite low in parts of the retail industry, there are indications that barriers may be higher in some sectors than would be desirable from a competition standpoint. One such indicator is the relatively high profitability of some Australian retailers in comparison with their counterparts overseas. Another indicator is the relative profitability of some retail companies in comparison with other Australian industries. In this regard, analysis by IBISWorld shows that many of Australia's larger retail firms have historically enjoyed relatively high returns on shareholders' funds (figure 2).

Another related indicator is the relative productivity of Australian retailers. The retail industry has experienced rates of labour productivity growth over the past two decades similar, on average, to that of the rest of the Australian economy. Notwithstanding this relatively sound performance in the *rate* of productivity growth, the *level* of productivity in the retail industry remains below that of most comparable countries in Europe and North America. Australia's retail industry labour productivity in 2007, in terms of output per hours worked, was lower than most OECD countries (figure 3).

**Figure 2 Return on shareholders' funds (after tax)**

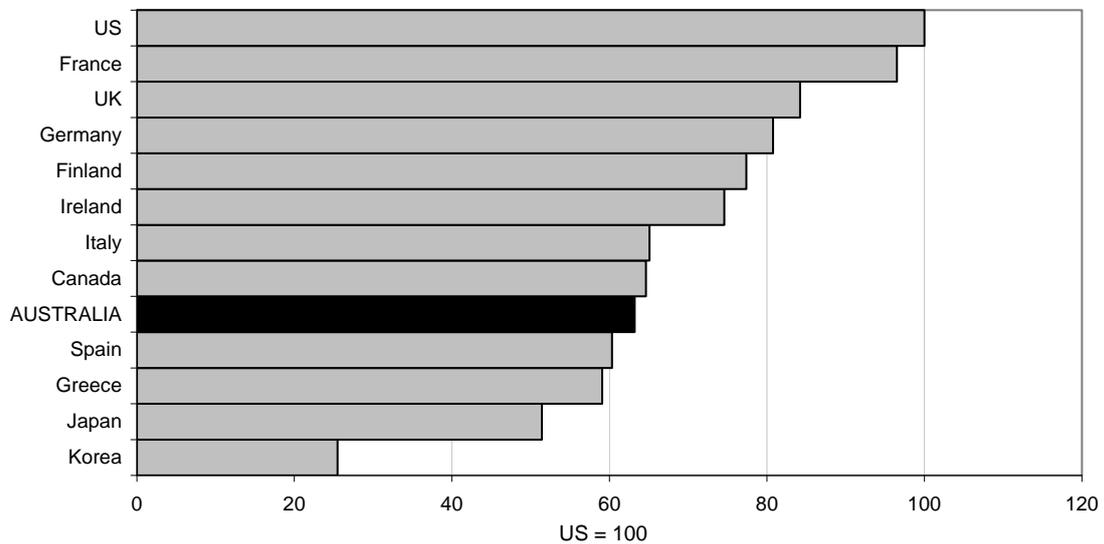
Top 1350 Australian businesses (5 years to 2009-10)



**Figure 3 Retail labour productivity, 2007**

Gross value added/hour worked

US = 100



It appears that the size of the gap in retail productivity between Australia and the leading overseas countries has been widening over the medium term. While it may not be realistic for Australia to attain similar productivity levels to those achieved overseas — especially compared to the United States — there would be benefits for

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consumers and retailers alike if Australian retailers started to close this widening productivity gap.

## **The nature of retailing is changing**

### **The rise of online shopping**

Much of retailing in Australia is changing in response to the increased competition arising from the popularity of online shopping. But the challenge of change is hardly new to the retail industry. Advances in technology and other retail innovations, mostly overseas changes adapted to local conditions, have led to the nature of Australian retail changing dramatically over many decades. The pressure from online retailing is not unique to Australia either — these competitive forces are being felt around the world.

The traditional intermediation role of retailers is being undermined in certain market sectors with manufacturers selling directly to consumers through the internet, thereby bypassing retailers. At the same time, different models of retailing are appearing — existing bricks and mortar retailers are incorporating online retailing and becoming ‘multi-channel retailers’ and a sizeable number of online-only retailers (‘pure plays’) have also emerged. Some of the new international bricks and mortar retailers are also investing directly in Australia and bringing novel business models and low cost international supply chains, which offer benefits to consumers. On the other hand, the activity of bricks and mortar retailers are unlikely to be affected as much by online suppliers where they offer services which are highly valued by the consumer, such as personal interaction, physical presence or immediate fulfilment.

The internet has changed the nature of retail competition not only by bringing far more competitors into the market, but also by changing the role of consumers. Many traditional retail services can now be easily carried out by consumers over the internet. People can use their computers, smart phones, and other mobile devices to compare the prices and features of dozens of goods from hundreds of retailers across the world and then arrange home delivery. Nor do consumers just rely on traditional advertising or product tests to inform themselves about a product. There is a proliferation of websites providing online reviews and customer discussion.

It is clear that online retailing is growing rapidly. But for such a widespread social phenomenon there is little hard evidence of the extent of online retailing in Australia. No official statistics are provided by the ABS on the size of domestic or

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overseas retail sales to Australian consumers. The Commission's analysis suggests that domestic online retailing represented around 4 per cent of total retail sales in Australia (approximately \$8.4 billion) in 2010. The Commission also estimates that purchases from overseas accounted for 2 per cent of total retail sales (approximately \$4.2 billion). Total online sales, therefore, accounted for 6 per cent, or \$12.6 billion, of all retail sales.

### **There are benefits from shopping online but 'buyer beware' is very important**

The reasons given by consumers for shopping online are many and varied but most surveys point to three key factors — price, range and convenience. The differences in retail prices between Australian bricks and mortar stores and the significantly lower prices offered by some online retailers — both domestic and overseas — have garnered attention in numerous media articles and studies, as well as in many public submissions to this inquiry.

While consumers are becoming increasingly confident about online shopping, they still require a keen awareness of potential risks in areas such as online security, product safety and warranties. Online service providers and traders have responded to consumer demands to improve online security and there appear to be further opportunities for the market to respond to other consumer protection issues associated with online shopping.

The consumer protection provisions of the *Australian Competition and Consumer Act 2010* apply in general to domestically based online traders in a similar fashion to bricks and mortar retailers. The legislation has been interpreted by the courts to include certain internet sales from businesses based overseas with no physical presence in Australia. However, there are likely to be practical difficulties in enforcing the law and obtaining a remedy for a breach in another jurisdiction.

Consequently, considerations of 'buyer beware' become critically important when shopping online from overseas sites. Currently, regulators provide information to improve online shoppers' understanding that goods purchased overseas may not meet Australian safety standards and about the potential difficulties in exchanging goods and obtaining refunds. They also provide warnings to consumers in relation to scam activities and advice to protect themselves against online fraud.

Over time, regulators may be required to work differently as well as devote more resources to addressing risks related to online purchases and product safety. International cooperation and agreements with overseas regulators will need to

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assume higher priority otherwise, there is a risk regulatory arrangements may not keep pace with this rapidly globalising and changing marketplace.

### **Regional price discrimination is now much more visible**

There are often large price differences between the goods offered by domestic and overseas retailers. Various factors can contribute to such price differences. They include access by retailers to competitive offers, out of season specials, differences in profit margins and underlying cost structures — for example, differences in rent and other occupancy costs, wages and other labour costs and government taxes.

The Commission is also aware of the longstanding practice by which some international suppliers set differential regional prices. This effectively treats consumers in one region as willing, or able, to tolerate significantly higher prices than those in other regions. Australian consumers have an increasing awareness of such price differences and are now able, in many cases, to circumvent them by directly ordering online. This represents an example of ‘parallel importing’ which is the import of genuine products without the permission of the local licensee. Some international suppliers have attempted to defend price discrimination due to the cost of supplying a remote and relatively small market like Australia, which in some cases has its own unique requirements. These arguments, in most cases, are not persuasive, especially in the case, for example, of downloaded music, software and videos where the costs of delivery to the customer are practically zero and uniform around the world.

Addressing such regional price discrimination is one of the main challenges for local retailers. If retailers cannot purchase the goods that they resell at competitive prices, more business exits and loss of employment will occur. The threat of parallel imports may help motivate international suppliers to change their regional pricing policies. It would seem likely that many international suppliers will want to retain local agents and retailers to support and service their products in the Australian market. From a policy standpoint, Government should ensure that any anticompetitive behaviour which inhibits retailers from purchasing competitively is addressed — in this regard there are reported attempts by distributors to limit parallel importing (box 1).

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**Box 1      Issues which may inhibit parallel importing**

Retailers have given examples of local agents or subsidiaries of companies supplying internationally traded goods threatening to withdraw supply if retailers attempt to parallel import some of their range. The ACCC advised that, although each situation would need to be carefully assessed with regard to the individual circumstances, generally a retailer should be able to parallel import and resell a genuine product legally purchased overseas. They would, however, need to carefully disclose any warranty issues or differences in the quality or style of the product compared to what consumers might normally expect. The behaviour of a local agent threatening to withdraw supply as a consequence of such action would need to be assessed, but might constitute illegal behaviour were it to substantially lessen competition or be considered a misuse of market power. (It should be noted, however, that these can be 'high hurdles' to prove.)

The operation of regulations affecting intellectual property rights have different impacts on genuine goods which are legally purchased overseas and are then parallel imported for subsequent resale. Generally, the Trade Marks Act does not prevent the resale of such goods bearing a trade mark which have been parallel imported. However, the Copyright Act can be used to prevent resale of parallel imported goods in certain circumstances.

For example, clothing or other goods which embody decorative graphic images, which have been purchased with the copyright owner's permission in another country cannot be parallel imported and then resold in Australia without the permission of the holder of the Australian copyright for the image. The law as it stands appears to have undesirable anticompetitive effects and confers more power on the owner of the copyright than applies in the case of the owner of a trademark. This matter should be considered by the Australian Law Reform Commission in its forthcoming examination of copyright law.

**Retailers' requests for assistance**

It is clear that some of the newly trade-exposed sectors of the domestic retail industry are not able to compete purely on price with overseas online retailers. The Commission has received submissions calling for more government assistance to the retail industry and for representation at a ministerial level of government. Government responses along these lines would not address the fundamental challenges facing the industry. Rather they run the risk of deflecting attention from reforms that would have a real impact and the actions that the industry itself should take to ensure market success.

The task for government is not to pick retail winners. Rather it is to help ensure that bricks and mortar and online Australian retailers can respond effectively to the

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increasingly global retail marketplace. This can be accomplished by not unnecessarily constraining retailers' ability to adapt their business models in response to changing consumer preferences.

## **Regulatory environment**

The retail industry operates under several broad regulations, including those that determine where retailers can locate, the nature and format of the stores that can be established, when they can open for business and their workplace arrangements.

### **Planning and zoning**

Planning and zoning regulation serves a valuable social purpose, but also restricts the flexibility of retailers in responding to consumers' preferences. In essence, the key question is to what extent the existing planning regulations prevent the entry of market participants beyond that consistent with achieving other planning objectives.

The Commission's 2011 report *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments* found that planning guidelines regarding where retailers can locate are extremely complicated and often prescriptive and exclusionary. In effect, they make it difficult for some new entrants to find suitable land and enter the market, and for existing businesses to expand or alter formats, thus interfering with the market's ability to allocate land to its most valued uses.

Specific restrictions on competition include: zoning which unnecessarily reduces land availability for particular uses; overly prescriptive local planning rules which inhibit entry and create unwarranted delay and costs through compliance burdens; and inappropriate protections of existing businesses and activity centres through adverse impact tests.

Businesses, for example, with new retail formats wishing to establish themselves in existing or proposed activity centres would be greatly assisted by broadened zone definitions and reduced prescriptiveness in planning regulations. For example, these changes could allow uses that included commercial, light industrial and retail in the one business zone, unless significant negative externalities might arise, such as traffic congestion, excessive noise or pollution. Industrial zones would then be limited to only high-impact industrial uses. Such planning and zoning changes would remove the need for ad hoc changes to council plans to accommodate each variation in retail business models. This would have three effects:

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- reduce the incentives for some retailers to distinguish themselves from other retailers to engender differential planning treatment in order to gain a competitive advantage through access to cheaper land
  - reduce the continual need for spot rezoning, thereby making it easier for governments to implement a consistent and coordinated approach to planning and land use
  - enable more, and facilitate the use of, ‘as of right’ development for retailers.

Using adverse impact tests to restrict new developments in an attempt to preserve existing businesses is quite common in the planning system, but in the Commission’s view is unjustifiable. To prevent new entry in an attempt to protect individual businesses or a group of businesses (such as a shopping centre) that may be less closely matched to evolving market requirements weakens the ability of retailers to respond to consumer preferences.

Providing sufficient land at the strategic planning stage, with sufficiently broad uses, should enable retailers to locate in areas where they judge they can best compete — planning should be able to accommodate even the newest of current business models requiring significant floor space. Under such conditions, a new retail proposal in a non-designated area should be rare. However, in this situation, considerations of externalities such as traffic congestion and the viability of existing or planned new centres can be an important aspect of city planning which may justify accepting some reduction in competition.

The proposed development of an out-of-centre retail location should be permitted where it is likely to generate a net benefit to the community, even if there are likely to be some detrimental impacts to an existing activity centre or to the commercial interests of individual businesses within that centre. Where business failures in existing centres occur, planning rules need to be sufficiently responsive to enable such centres to be revitalised in a timely fashion by a different mix of businesses or uses.

Now that consumers can shop for many goods from their homes for reasons of convenience — undermining locational advantages enjoyed in the past by some forms of retail — the flexibility of the planning system becomes an increasingly important consideration in the capacity of bricks and mortar retailers to both compete and improve their productivity.

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## Retail tenancy

Planning and zoning constraints appear to be the root cause of many of the concerns in the retail tenancy market expressed to the Commission. Simply put, occupancy rates are extremely high in shopping centres due to strong demand for retail space in the face of constrained supply. This places smaller retailers — who do not have the bargaining power of anchor tenants or chain specialty stores — in a very tough bargaining situation (box 2). While it is possible for these retailers to ‘vote with their feet’ and move to shopping strips or other locations, the alternative sites are not always commercially attractive.

### Box 2 Continued concerns about retail tenancy

The market for retail tenancy leases is important for retailers because occupancy costs are one of the major cost drivers for the retail industry. The main concerns raised by participants to this inquiry relate to leasing arrangements within shopping centres. Similar concerns were raised in the Commission’s 2008 retail tenancy inquiry.

There is scope to improve the retail tenancy market by removing unnecessary restrictions on competition and constraints on the supply and location of retail space through reforms to the planning and zoning regulations. Implementing these reforms 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.

Retail tenancy legislation that has sought to influence conduct through prescribing aspects of the landlord–tenant relationship has not been successful in improving relationships between landlords and tenants in shopping centres. The adversarial nature of the relationship between landlords and tenants and the more extreme negotiating tactics could be potentially moderated by the introduction of a voluntary national code of conduct for shopping centre leases as previously recommended by the Commission’s retail tenancy inquiry report in 2008.

In the Commission’s view, further refinements to retail tenancy regulation are unlikely to result in significant improvements to the operation of the retail tenancy market given the distortions and constraints arising from planning and zoning regulation.

## Trading hours

Legislation regulating retail trading hours has varied objectives, including providing some small businesses with the opportunity to trade without competition from larger retailers. In recent decades, some state governments have recognised that changes in

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social patterns — such as the attractiveness to some employees of more flexible and non-traditional working hours, the growing participation of women in the workforce and growth of both dual income and single parent households — have necessitated changes to retail trading hours, and they have relaxed some trading hours restrictions.

Trading hours are fully deregulated in the ACT and the Northern Territory — retailers can choose to trade whenever they want, including on public holidays. Beyond the two territories, restrictions on trading hours apply with varying levels of intensity, with Western Australia, South Australia and Queensland having the most restrictive regulations. The experience with deregulated trading hours is that most retailers do not trade 24/7. Instead they choose to open at times when consumers are most likely to want to shop for the goods they sell, and when they can trade profitably. This means that many retailers, for example, voluntarily remain closed on traditional public holidays such as Christmas Day, Good Friday and the morning of Anzac Day.

Currently, regulations on trading hours vary between and within jurisdictions, but in all cases where they are present, some retailing services are exempted. Restrictions tend to discriminate between retailers on the basis of products sold, size and location.

Trading hours regulation has also been seen as assisting retail workers to maintain contact with their families and the broader community by ensuring common leisure time. But there does not appear to be any compelling evidence of a relationship between the regulation of retail trading hours and such social connectedness.

The Commission is aware that there will be some workers who do not want to work, for example, on Sundays or public holidays even with the added remuneration arising from the payment of penalty rates. But it should also be recognised that deregulation of trading hours provides those individuals who prefer to work outside of ‘normal hours’ with job opportunities they would not have otherwise. And for other workers there is the opportunity to earn additional income by receiving penalty rates for such work.

As consumers have become increasingly time poor, they have placed a higher value on shopping convenience in terms of when they can shop and where they can shop. Shifting to online shopping may mitigate the loss of consumer welfare to some extent. However, forcing shoppers online because of restrictions on trading hours does not maximise consumer welfare. Also such restrictions constrain bricks and mortar retailers in responding to consumer preferences.

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In today's more competitive retail trading environment, where consumers have greater access to goods from all over the world and can order those goods any time of the day or night, there is a greater imperative for retailers to have the ability to respond to changing consumer tastes and preferences. Indeed, there appears to be some evidence that there has been greater use of online retailing in states where shopping hours are restricted.

The Commission proposes that retail trading hours should be fully deregulated in all states, just as they are in both the territories.

### **Workplace practices**

The retail industry is highly labour intensive with over 70 per cent of its value added accruing to workers in the industry. Accordingly, the way in which workers are employed, their productivity and the flexibility of workplace practices are important for the future of the industry. Because workplace employment regulations underpin workforce engagement decisions, they play an important role in shaping workplace practices, competitiveness and productivity outcomes and therefore have been considered in this report. The level of award reliance of the retail workforce, although declining, remains relatively high. This suggests that many retail employers and their employees have not taken full advantage of the opportunities that have existed under past and current workplace regulations to examine how their workplace practices might be improved to lift productivity. Various stakeholders have clearly different views regarding the operation of workplace employment regulations (box 3).

It is clear that if those sectors of the Australian retail industry now exposed to international competition are to have the best chance of competing effectively, the productivity of workers will need to more than keep pace with future wage movements. The competition from overseas online retailers will place pressure on domestic retailers' existing activity and employment levels. A strong commitment will be required from employers, employees and unions to working cooperatively through agreement making, but also more broadly to deliver productivity improvements and narrow the existing gap between the Australian retail industry's productivity levels and international best practice. Narrowing the productivity gap between retailers in Australia and those overseas — who now, through the online medium, are effectively direct competitors in many retail sectors — will be of critical importance for the future prosperity of this industry, its employees and for Australian consumers.

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**Box 3 Differing perspectives on current workplace regulations**

Unions and individual workers have highlighted the relatively low levels of pay in the industry and argue that current awards and workplace relations regulation provide sufficient flexibility. On the other hand, retailers and employer groups raised a number of concerns about the implications for total employment costs and operational flexibility of awards and various Fair Work Act provisions.

A particular concern expressed by these latter groups, relates to increases in penalty rates faced by some retail employers as a result of award modernisation and, as a consequence, the impact on their ability to trade profitably at certain times when high penalty rates apply. Were penalty rates contained in the harmonised award to result in many retailers choosing not to open at times preferred by consumers, there may end up being detriment to all stakeholders, including consumers. If this were to be the case then the only likely way to start to resolve this would be for an agreement to emerge between employers, employees and unions that the current arrangements should be revised.

Retailers have also claimed that they are constrained by the level of award wages in their attempts to restructure employee remuneration in ways that could enhance productivity, for example, through greater use of performance-related commissions or incentive payments. Provisions governing the making and approval of enterprise agreements, in particular the 'every worker must be better off overall' test, are also said by employers to be increasing the cost and complexity of negotiating enterprise agreements thus making productivity improvements more difficult to achieve. At the same time, it is claimed constraints on the negotiation and operation of individual flexibility arrangements has meant that they do not, in practice, offer the sort of flexibility desired.

Submissions from unions and many employees in the retail industry incorrectly drew the inference that the Commission's comments in its draft report about the need for productivity improvements in the retail industry were akin to advocating a reduction of wages and penalty rates and an erosion of conditions of employment. The Commission did not, and has not in this final report, made any specific findings or recommendations in relation to pay and conditions for retail employees.

The concerns raised by retailers suggest there could be scope to improve the operation of workplace regulation to enhance flexibility and adaptability at the enterprise level. But it will be necessary to ensure that important safety net provisions are maintained. It is, therefore, important that there is a rigorous, evidence-based and balanced consideration of possible reforms. Any examination of workplace relations regulation will need to consider matters beyond the retail industry and it is not appropriate in the context of this inquiry for the Commission to recommend specific changes.

Two reviews scheduled for 2012 provide an opportunity to examine the issues raised with this inquiry more fully. The review of modern awards should consider

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the concerns that relate specifically to the operation of relevant awards, including the General Retail Industry Award. The post-implementation review of the *Fair Work Act 2009* will be a timely opportunity to examine broader concerns about aspects of the operation of the Act.

## **Appropriateness of current indirect tax arrangements**

### *The economic impact of the low value threshold*

Many submissions to this inquiry suggested that the level of the low value threshold (LVT) for application of GST and duty to imports is undermining the competitive position of Australian retailers in comparison to overseas online retailers. Consumers are able to import goods from overseas retailers free of GST and customs duty up to a limit of \$1000, whereas Australian retailers must incur the costs of GST and duty (where applicable) on the goods they sell.

In principle, the GST, as a broad based consumption tax, should apply equally to all transactions, to ensure tax neutrality across different markets and goods — in other words, overseas and domestic retailers should be treated similarly. A low value threshold for imports can be seen as operating as a ‘negative tariff’ for the domestic retail industry and their suppliers. Under these circumstances, the domestic industry receives negative assistance in that the industry’s activities are taxed while overseas competitors are not. This can be seen as undermining the principle of tax neutrality, thereby distorting resource allocation.

As a consequence, it can be expected that domestic retail sales will contract somewhat due to the operation of the threshold and some resources may flow from the more efficient activities in the domestic retail industry towards less efficient alternatives. However, consumers benefit by way of lower prices on imported goods below the value of the threshold.

Another principle is that taxes should be collected efficiently to minimise the ‘deadweight loss’ for the community. This deadweight loss arises from not only the administrative and compliance costs, but also any undue delays in delivery to businesses and consumers that may result from the processes of collection. Public policy analysis of this question must factor in the overall economic benefits and costs of lowering the threshold.

The low value threshold with respect to the application of customs duty undermines the protective effect of the tariff assistance provided to industries where duty is applicable. Again, however, the negative effect of the threshold on industry needs to

be weighed against the benefits consumers receive from lower costs of goods and the administrative and compliance costs of collection. These collection costs for duty are currently likely to be far more substantial than the costs of the collection of GST because of the varying rates of customs duty according to product category and source country. Ascertaining the correct rate of customs duty is often beyond the expertise of ordinary consumers and can require the assistance of customs brokers.

Indicative analysis carried out by the Commission suggests that the welfare gains from lowering the threshold are not large in comparison to the current collection costs. This emphasises the importance of ensuring that collection costs are substantially reduced before any decision is taken to reduce the level of the threshold thus ensuring that the revenue raised is collected in a cost effective manner.

#### *Revenue and costs of collection*

Low value parcels entering Australia do so through two broad streams — the express courier and the international mail streams. The vast majority enter through the international mail stream. In 2010-11, 10 million parcels entered through the express courier stream and the Commission estimates that over 47 million parcels entered through the international mail stream (table 2).

**Table 2 Estimated number and value of international mail parcels entering Australia, 2010-11**

<i>Value range</i> \$	<i>Percentage in range - lower estimate</i>	<i>Percentage in range – upper estimate</i>	<i>Estimated number of parcels in range</i>  <i>Millions</i>
0-100	68.59	75.16	34.85
101-200	12.85	12.95	6.26
201-300	4.85	6.11	2.66
301-400	2.45	3.73	1.50
401-500	1.61	2.34	0.96
501-600	1.17	1.18	0.57
601-700	0.88	0.89	0.43
701-800	0.02	0.37	0.09
801-900	0.02	0.26	0.07
901-1000	0.02	0.28	0.07
<b>Total</b>			<b>47.46</b>

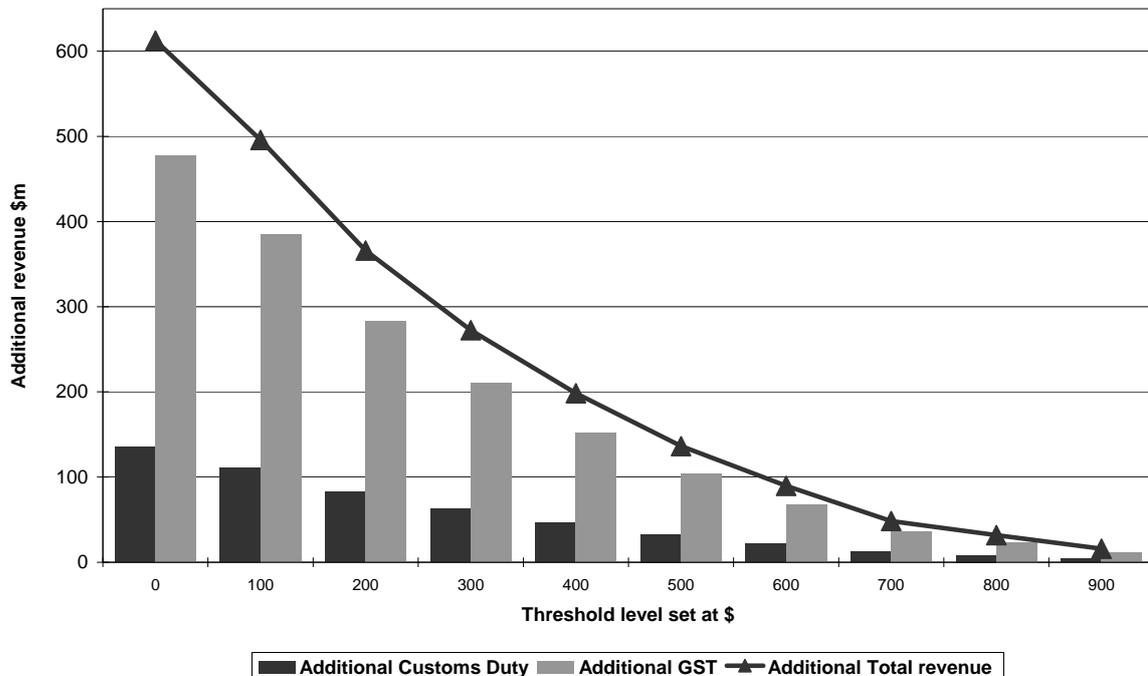
Table 2 presents the current analysis of the value of mail parcels, based on information provided by Australian Customs and Border Protection Service

(Customs). A significant majority of parcels by number had a value well below \$100.

The Commission has estimated the additional revenue that might be collected if the threshold were reduced (see figure 4). For reasons of simplicity this analysis ignores any consumer price response due to the consequent taxes and additional costs imposed. Because the value of the majority of international parcels is low, significant amounts of tax revenue do not start to be collected until the LVT is also quite low.

**Figure 4 Estimated additional gross revenue (excluding collection costs) at lower threshold levels, 2010-11**

For air cargo and international mail



The current processes in the Australian mail system for assessing the GST and duty payable, and collecting this (plus the processing charge of \$48.85), are very labour intensive and involve a complicated and time consuming multi-step process between Customs, Australia Post and the consignee. The express couriers' process appears somewhat more efficient, with a slightly lower processing charge (\$40.20).

*The implications from lowering the LVT*

A decision to lower the LVT under current processing arrangements would only be supported by the Commission if the net benefits to the community from the

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improvements in tax neutrality were sufficiently high to cover the very high collection costs. The Commission's assessment is that this is not currently the case.

Taking the current collection charges as a crude proxy for *all* collection costs (and ignoring the possible need to engage a customs broker) what would happen if Australia simply lowered its threshold to a level like that of Canada — a LVT of \$20? Many submissions have advocated such an approach. This would satisfy the requirements of tax neutrality by subjecting the vast majority of incoming parcels to GST and duty collection. Over 30 million mail parcels would then need to be processed for GST and duty — compared to the level of 20 000 parcels in 2009-10. Lowering the threshold to \$20 would raise in excess of \$550 million in tax revenues but the cost of the processing using the current system would escalate to over \$2 billion — more than three times the additional revenue collected. Moreover, the Commission's indicative modelling suggests that, given the current high deadweight costs of collection, even after taking into account the gains flowing from greater tax neutrality, the net impact on overall community welfare would almost certainly be negative.

An alternative approach would be to make only a small movement towards a lower threshold — to \$900 for example. But this would leave 99 per cent of parcels with no tax and duty collected, making little difference to tax neutrality and failing to address concerns about 'the lack of a level playing field'. At this threshold level, the number of mail parcels required to be processed would be over three times the current level, and with the current processing system, even this small increase is likely to cause significant delivery delays. Moreover, in the Commission's judgement, an interim and partial reduction would be mainly symbolic and likely to consume resources that would better be devoted to exploring the best and most expeditious manner to reduce collection costs and enable a cost-effective approach to greater tax neutrality.

### *There is a need to improve parcel handling processes*

Before any decision is taken to reduce the threshold, collection costs need to be reduced. The current parcel handling logistics processes used in Australia by Customs and Australia Post need to be significantly improved. In fact, such processes need to be examined even without changes to the LVT as they appear not to be up to the task of accommodating the future demands from the expected growth in online retailing. An overall examination of the processing system should also seek to lower costs of processing incoming parcels handled by express couriers. The challenges are less than with the mail system, but costs are still far too high to be appropriate with a much lower LVT.

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A reasonable question to ask is why the current processes are so manual and ‘clunky’ given the availability of sophisticated technology and automation. The more sophisticated tracking and parcel information systems of the express couriers, for example, are clearly superior to the mail system at this point. The answer is twofold.

Firstly, the existence of a high LVT has not created a need for the postal and customs processes to be upgraded. Even with the growth in overseas online shopping, the number of parcels to be processed has, until recently, been manageable. Secondly, the mail system is subject to international agreements which include many countries with limited capacity to make rapid technological improvements to their parcel systems.

*Where to from here?*

The Government should establish a taskforce of independent experts, advised by representatives from Customs, Australia Post, Australian Quarantine and Inspection Service (AQIS) and the express couriers, to investigate a new approach to processing parcels, particularly those in the international mail stream. Given process improvements in other countries to draw on as examples, there is no reason not to expedite this investigation and set the taskforce a timetable of reporting in 2012. Design criteria for a new approach to processing parcels are set out in box 4.

**Box 4      Design criteria for parcel processing**

The design criteria for a new approach to processing parcels should include:

- imposing minimum delays in the delivery of parcels to businesses and consumers
- allowing for the large expected increase in parcel volumes associated with the growth of online retailing
- passing on collection costs to the end consumer
- minimising manual processes to the greatest extent possible
- imposing no added barrier to trade, or protection of domestic industry from import competition
- not having a higher threshold for gifts, if this would add to complexity and to incentives to inappropriately use any special exemption
- being compatible with the needs of Customs and AQIS for their other border protection responsibilities.

Overseas approaches to the collection of tax revenue should be examined by the taskforce, including the overseas online retailer practices of upfront tax collection,

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the use of the postal service to collect revenues and charges, and the simplification of duty assessment. Some of these initiatives are set out in box 5.

**Box 5      The rapidly changing world of handling parcels**

Other countries, such as the United Kingdom and Canada have been grappling with the challenges of processing and handling significantly increased volumes of mail parcels and collecting tax and duties on them. Several have developed improvements that may hold promise for Australia. These include:

- encouraging online retailers to design their systems so that the costs to consumers (including taxes) are included and visible at the time of ordering and payment. These goods then enter the destination country either with the taxes prepaid and directly remitted by the vendor, or with the taxes being handled by a local broker (primarily this occurs in the case of express couriers). For the consumer, the process is seamless (with no delay in delivery). Such online shopping designs already exist for a number of major online retailers in other countries — not necessarily because of government prompting, but as a competitive service to their customers
- the use of more intelligent bar codes for parcels moving through the mail. This is currently under consideration by some of the larger international mail agencies. Trials are also being carried out involving the exchange of data files containing information about the contents and value of mail parcels which would facilitate more efficient processing and clearance through Customs
- in other countries, the postal service is the collector of revenues. For mail parcels entering Australia, using Australia Post to collect the revenue and processing charges, rather than the current multi-step ‘clunky’ process between Australia Post and Customs could improve efficiency. This mechanism would likely require enabling legislation in Australia
- other countries like the United Kingdom and Canada have also greatly simplified duty assessment by having a limited number of rates and classifications (e.g. ten or less) for low value items. The current Australian system of entering items by individual tariff code is complicated, often requiring the use of a customs broker. An alternative might be to have a higher threshold for the application of duty than that applied to GST, given the relatively small amount of additional revenue collected through duties.

The Commission also examined whether the duty and GST thresholds should remain linked and formed no definitive view. There is no overwhelming reason for these thresholds to be linked, however, the rationale for retaining their linkage — competitive neutrality and administrative simplicity — will rest on the assessment of the collection costs and decisions with respect to duty simplification. The taskforce should also assess this matter as part of its terms of reference.

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Once the taskforce reports with its recommended new approach to processing parcels, the LVT should then be reassessed and the appropriate threshold for Australia determined.

In determining the most appropriate level to which the LVT should be lowered, the additional tax revenue from all sources should be compared to the costs of collection and any other costs to consumers and businesses, such as the loss of consumer surplus.

An appropriate timeline and any transitional arrangements for implementation should also be recommended by the taskforce. The Commission understands that the investment required in the mail system is likely to be significant and it could take some time to reach full implementation.

This approach, however, does not address the issue of what to do about the taxation of imported intangibles such as downloaded music and software (box 6).

**Box 6      The position regarding taxes on imported intangibles**

The Commission notes that any move to lower the level of the LVT would have no impact on the taxation of the importation of services and intangibles — for example, downloads of software, music and games. Treasury estimates that such imports currently give rise to around \$1 billion of GST revenue foregone. The Commission is not aware of any international examples of countries outside the European Union that have successfully found a method of cost effectively collecting taxes on these intangibles, although it is aware that many countries continue to be concerned about this growing source of revenue leakage. The Australian Government and particularly the ATO should maintain a watching brief on any international developments which might facilitate tax collection on imported intangibles. Any effective approach to this issue would appear to require international cooperation.

A number of retailers and retail associations expressed support for the Commission's draft recommendation that in principle the LVT should be lowered, but expressed great concern about the time delays involved in the process recommended. But the retailers' competitive disadvantage caused by the current lack of tax neutrality is not seen to be sufficient reason to hastily implement a costly and inefficient system. Indeed, the current level of the LVT is judged not to be the most significant factor explaining the growth of online shopping from overseas websites. Consumers are also responding to the generally lower prices, greater product range and convenience offered by online shopping from overseas compared to that offered by many bricks and mortar stores in Australia. However, the Commission accepts that the process for moving to implement an improved collection system and a lower LVT should be progressed expeditiously.

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For this reason, the Commission has recommended that the taskforce should report in 2012 recommending a tight, but achievable timetable for improving the processing system.

### **Other regulatory burdens**

Participants raised a range of other concerns about regulations at the Australian and state, territory and local government levels that in their view are hindering the retail industry's ability to respond efficiently to the demands and preferences of consumers. In particular, retailers that operate across jurisdictions are experiencing inefficiencies in their operations as a result of inconsistent regulations across jurisdictions. For example, the differing requirements relating to the display of tobacco products, or broader areas of concern to industry such as transport; environmental; occupational, health and safety and taxation regulations.

Several of the concerns raised are not new and have been examined in previous Commission reports or other review processes. Others are the subject of ongoing review and reform processes, for example, as part of the COAG 'national seamless economy' reform agenda. However, they highlight the need for governments to continue to prioritise efforts directed at the review and reform of regulations that are unnecessarily burdensome and to reduce regulatory inconsistency across jurisdictions where that would afford net benefits to business and the community. They also suggest the need to consider 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.

### **The process of change**

Retailers face a changing market landscape and a stronger requirement than in the past to respond to changing consumer preferences and new international online competitors. They need to consider ways to improve their levels of productivity and competitiveness. The pursuit of international best practice productivity and service levels will require improvements on many fronts. These include: better customer and after sales service; superior logistics and management of working capital; greater automation; better management and leadership; and a multi-skilled and flexible workforce prepared to lead and facilitate innovative means of delivering value for customers, in some cases with better staff and management alignment through incentives or commissions.

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In a recent submission to the House of Representatives Standing Committee on Economics, the Commission noted that improving productivity at a firm level involves a number of inter-related components which can be summarised under the headings of:

- incentives — the external pressures and disciplines on organisations to perform well. The most critical incentive usually being competition. Arguably, the retail industry in Australia has historically experienced a relatively benign competitive environment compared to that in other countries. This may have reduced incentives for retailers to see productivity improvements as a priority. The growth of online retailing is clearly changing this environment
- flexibility — the ability to make changes to respond effectively to market pressures. Here workplace regulations, planning and zoning and trading hours regulations are important factors
- capabilities — the human and knowledge capital, as well as infrastructure and institutions, that are needed to make necessary changes. This importantly includes the quality of leadership and management in an organisation. The retail industry has invested considerable capital over the past two decades, but has lagged in recent years in raising its levels of multifactor productivity. To do so will require more innovative use of the combination of capital and labour, to develop new and better ways of delivering the products and services that consumers want.

All three components influence the motivation and ability of organisations to innovate and adopt improvements. Government policies have an important role to play in helping to ensure that competition is not restricted and in ensuring that regulations do not unnecessarily hinder firms from addressing the issues that are rightly their responsibility.

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## Recommendations

### Trends and issues related to online retailing

#### RECOMMENDATION 4.1

*The ABS should monitor and report online expenditure both domestically and overseas by Australian consumers. The ABS should also consider options that will enable the disaggregation of online spending and employment associated with ‘multi-channel’ establishments and ‘pure play’ online retailers.*

### Retail price differences

#### RECOMMENDATION 6.1

*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 clothing or other goods which embody decorative graphic images sold with the copyright owner’s permission in another market.*

### Appropriateness of current indirect tax arrangements

#### RECOMMENDATION 7.1

*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.*

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*The Government should establish a taskforce charged with investigating new approaches to the processing of low value imported parcels, particularly those in the international mail stream, and recommending a new process which would deliver significant improvements and efficiencies in handling. The taskforce should comprise independent members, with the Australian Customs and Border Protection Service (Customs), the Australian Quarantine and Inspection Service (AQIS), Australia Post and the Conference of Asia Pacific Express Carriers providing advice. The terms of reference should outline the criteria that any new system must satisfy including: minimising the costs of processing and delivery delays, streamlining the assessment of Customs Duty, user pays, and without compromise to the border protection functions of Customs and AQIS. This review should report to Government in 2012 and propose an expeditious timeframe for its proposed changes.*

*Once an improved international parcels process has been designed, the Australian Government should reassess the extent to which the LVT could be lowered while still remaining cost-effective.*

## **Planning and zoning regulation**

*State, territory and local governments should (where responsible) broaden business zoning and significantly reduce prescriptive planning requirements to allow the location of all retail formats in existing business zones to ensure that competition is not needlessly restricted. In the longer term, most business types (retail or otherwise) should be able to locate in the one business zone.*

*Governments should not consider the viability of existing businesses at any stage of planning, rezoning or development assessment processes. Impacts of possible future retail locations on existing activity centre viability (but not specific businesses) should only be considered during strategic plan preparation or major review — not for site specific rezoning or individual development applications.*

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RECOMMENDATION 8.3

*State, territory and local governments should facilitate more as-of-right development processes to reduce business uncertainty and remove the scope for gaming by competitors.*

RECOMMENDATION 8.4

*State and territory governments should ensure third party appeal processes within planning systems include clear identification of appellants and their grounds for appeal and allow courts and tribunals to award costs against parties found to be appealing for purposes other than planning concerns.*

RECOMMENDATION 8.5

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

## **Retail tenancy leases**

RECOMMENDATION 9.1

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

## **Retail trading hours regulation**

RECOMMENDATION 10.1

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

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## Workplace relations regulation

RECOMMENDATION 11.1

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

*The first review of modern awards by Fair Work Australia, scheduled for 2012, is a further opportunity to address concerns that relate specifically to the operation of relevant retail awards. This review should also provide adequate opportunity for input from all relevant stakeholders.*

## Other regulatory burdens

RECOMMENDATION 13.1

*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.*



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# 1 About the inquiry

Retailing is an important economic activity as it provides the interface between the production and distribution of goods and their consumption by the Australian community. As well as providing this service, retail is a significant activity in its own right — the retail industry is one of Australia’s largest employers. Currently, there are almost 140 000 retail businesses employing about 1.2 million people or 10.7 per cent of the total working population in 2009-10. The retail industry also makes a significant contribution to economic output, contributing \$53 billion or over 4.1 per cent of GDP in 2009-10 (ABS 2010b).

The retail industry has always been subject to change and competition. However, technological change and globalisation are now exposing the sector to more intense competition. Some of what retail has to offer is now a tradeable service, that is, one that can be supplied online from overseas retailers. This is reflected in the Ministerial Joint Media Statement announcing this inquiry which, while emphasising its broad scope, specifically noted that the inquiry will provide an insight into the challenges faced by Australian retailers in an increasingly globalised shopping world (Shorten et al. 2010).

## 1.1 What the Commission has been asked to do

The Government has asked the Commission to undertake an inquiry into the implications of globalisation for the retail industry and the appropriateness of current policy settings in this environment. More specifically, the Commission is to examine:

- the current structure, performance and efficiency of the retail industry and impediments to its contribution to the Australian economy
- the drivers of structural change in the retail industry, including globalisation, increasing household and business access to the digital economy, cost structures of the domestic retail industry, employment structure, the exchange rate and structural change driven by the resources boom
- the broader issues which are contributing to an increase in online purchasing by Australian consumers and the role of online purchasing in providing consumers with greater choice, access and convenience

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- the sustainability and appropriateness of the current indirect tax arrangements in this environment, including the impact on Commonwealth and state and territory budgets and the extent to which technology could reduce the administrative costs of collecting indirect taxes and duty on imported goods
  - any other regulatory or policy issues which impact on structural change in the industry.

## 1.2 Scope of the inquiry

The definition of what constitutes the retail industry is central to this inquiry and in identifying the issues facing the industry. The Australian Bureau of Statistics' Australian and New Zealand Standard Industrial Classification 2006 (ANZSIC) describes the key aspect of retail as 'units mainly engaged in the purchase and onselling, commission-based buying, and commission-based selling of goods, without significant transformation, to the general public'.

Retailers have typically operated from premises positioned and designed to attract walk-in customers, have a display of goods and use advertising to attract customers. The most common experience consumers have of a retailer is perusing and buying goods from a 'shop'.

However, not all businesses that operate from 'shops' are retailers — for example, shop-based businesses such as travel agents are classified in the Administrative and Support Services industry and video rental stores are classified in the Rental, Hire and Real Estate industry. Conversely, not all retailers operate from 'shops' for example, the retail industry includes direct selling and online selling. It is the buying of goods for onselling to the public that is the chief characteristic of the retail industry.

Retail is categorized as Division G of the ANZSIC. Under this classification, the retail trade division contains five industry subdivisions:

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

This inquiry relies on the ABS definition of what constitutes 'retailing' and focuses on issues connected to this industry. But there are times in this inquiry where it has

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been judged important to adopt a somewhat broader approach. Much of retail is closely connected to the delivery of products and services by the transport, postal and warehousing industry (Division I) and access to property through the property operators and real estate services industry (Division L). Online retailing is associated with the information media and telecommunications industry (Division J). Issues have been identified which involve these industries — including planning and zoning regulation and the logistic support for online retailing. Accordingly, the discussion of issues which affect the retail industry have relevance to these other industries.

In the issues paper, for this inquiry, the Commission indicated that it would exclude from general consideration the fuel retailing and motor vehicle and motor vehicle parts retailing sub-divisions of the retail industry but would consider any submissions that raised specific issues of relevance to these sub-divisions that lie within the terms of reference. No such submissions on fuel and motor vehicle retailing have been received and therefore the Commission will not be including these activities within the discussion. The inquiry did receive a submission dealing with the retailing of motor vehicle parts which is considered in this inquiry. When the Commission presents statistical data on the retail industry in this report, it will identify when these data include motor vehicle and motor vehicle parts retailing and fuel retailing.

In addition, the Commission did not examine broader policy issues associated with pharmaceutical retailing. Pharmacies are specialist outlets with complex connections to broader public health policies such as the pharmaceutical benefits arrangements. However, pharmaceutical retailing is an area where competition from internet suppliers of prescription and non-prescription medicines is growing and consumer safety issues have been raised in the course of this inquiry. These have been examined in this report.

In undertaking its task — that is, assessing the efficiency and performance of the retail industry, as well as the regulations applying to the industry and the operation of the current indirect tax arrangements — the Commission has adopted a community-wide framework, as required by the *Productivity Commission Act 1998*.

Thus, while the terms of reference direct the Commission to assess the implications of globalisation and other drivers of change on the retail industry, the focus of the inquiry is on the impacts on the community as a whole. This is made explicit in the terms of reference which direct the Commission to address the role online retailing plays in providing consumers with greater choice, access and convenience, as well as the implications for indirect taxation arrangements.

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The terms of reference also require the examination of the sustainability and appropriateness of current indirect tax arrangements, with particular reference to indirect taxes and duty on imported goods. The retail industry is affected by a number of other indirect taxes, such as payroll tax and land tax, which affect all Australian industries. As indicated in the issues paper, except where indirect tax issues specific to the retail industry have been raised with the Commission, it has focused this report on the current arrangements relating to indirect taxes and duty on imported goods.

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

The Commission received the terms of reference from the Assistant Treasurer on 3 February 2011. Under the terms of reference the Commission is to report by November 2011. The Commission has encouraged stakeholder and broader community involvement in the inquiry and provided opportunity for input within the limited timeframe of the inquiry. The Commission:

- upon receiving the reference, released a circular announcing the commencement of the inquiry, and advertisements were placed in major newspapers as well as on the Commission's website
- held informal consultations with retailers, government agencies and peak groups representing the retail industry and consumers
- released an issues paper at the end of March 2011, expanding on the terms of reference and invited interested parties to provide submissions, which were due by 20 May 2010
- held a roundtable with Australia Post, Australian Customs and Border Protection Service, the Treasury and the Department of Broadband, Communications and the Digital Economy
- visited parcel processing facilities
- received 129 written submissions from retailers, other industry stakeholders, consumers and government agencies prior to the release of the draft report which appear on the Commission's website
- released a draft report on 4 August and invited interested parties to provide submissions which were due 2 September
- held public hearings in Melbourne on 5 and 6 September and in Sydney on 12 and 13 September
- held further informal consultations with government agencies and stakeholders
- received an additional 110 submissions after the release of the draft report.

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The Commission records its thanks to all those who contributed to this inquiry, especially those who provided written submissions and participated in meetings, hearings and the roundtable.

## 1.4 A guide to the report

Most of the issues raised through this inquiry are presented under broad thematic headings. **Chapter 2** describes how the character of retailing has changed in response to technological and consumer trends. **Chapter 3** presents a snapshot of the economic state of the retail industry.

The next four chapters deal with the increased globalisation of retailing and consequences for consumers, the industry and government revenues. **Chapter 4** describes the growth and extent of online retailing and the issues raised for consumers and retailers. **Chapter 5** describes consumer protection issues associated with online shopping. **Chapter 6** investigates the reasons underlying the price differences confronting consumers shopping online and from bricks and mortar retailers. **Chapter 7** looks at the issue of the low value threshold for exemption from the GST and customs duty on imports and the impact this has, including the impact on government revenues. This chapter also examines the options for changes to the threshold and the impacts these may have on parcel processing systems and costs.

The impact of government regulation on the flexibility and productivity of retailers is dealt with in the following four chapters. **Chapter 8** looks at planning and zoning regulatory restrictions on the ability of retailers to enter the marketplace and their flexibility to develop innovative store formats. **Chapter 9** addresses the consequences of retail tenancy legislation for the retail industry. **Chapter 10** focuses on the effects of the regulation of shopping hours on the operation of retailers and their ability to respond to consumer preferences. The effects of workplace relations regulations on enterprise flexibility and productivity are examined in **chapter 11**.

**Chapter 12** describes the characteristics of the retail workforce and changing skill requirements arising from the growth of online retailing. **Chapter 13** addresses a range of other regulatory burdens raised in submissions.

The appendices contain information regarding the consultation undertaken by the Commission with government agencies, industry and representative bodies as part of this review, as well as data and more detailed information underpinning the Commission's findings in the body of the report.



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## 2 The role and development of Australian retail

### Key Points

- Traditionally, the retail industry has been the main conduit between manufacturers/wholesalers and consumers, providing functions such as convenience points for consumers and market discovery for products. However, with the advent of online shopping and purchasing of goods in the digital age, these functions have since also been provided through the online experience.
- The development of Australia's retail industry has been driven by a range of factors, including technological advances, changing consumer preferences and competitive pressures, with many innovations in Australia's retail history following international precedents.
- In the past, Australia's retail industry has been relatively isolated due to its geographic position and protected markets, but with the embrace of the internet and digital technology, the industry is becoming increasingly part of an integrated global marketplace. Further, a number of innovative global retailers are arriving to set up and compete physically in the domestic market.
- Online shopping is a significant development in Australia's retail history, and it provides both challenges and opportunities for the industry. New retailer-types have emerged in the marketplace, competition has broadened beyond geographic borders and innovative ways of shopping are being embraced by increasingly technologically-savvy consumers.

### 2.1 What is the role of retail?

The retail definition discussed in chapter 1 characterised retailers as intermediaries between manufacturers or wholesalers and consumers. That is, retailers mainly buy goods from manufacturers and wholesalers and resell them to consumers. While this view of retailing may account for its essential character, it does not cover the range of functions carried out by the industry. It does not fully explain what it is that retailers do to add value to the goods sold nor help to identify the competitive pressures which retailers may face into the future.

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Retailers carry out a number of functions which add value to the goods supplied and provide utility to consumers. These functions include providing:

- convenience for consumers to purchase goods
- a market discovery mechanism
- after sales and other ancillary services.

#### *Acting as a point of convenience for consumers*

Retailers enable goods to be purchased in smaller quantities than usually provided by manufacturers or wholesalers and physically reduce the size of packaging of goods that consumers can conveniently buy. They also provide a stocking service for consumers as, rather than maintain large stocks of goods at home, they can rely on retailers to maintain the required levels of stock to replenish on a needs basis. This service is clearly seen in local general stores or service station convenience stores where consumers may make frequent (often daily) purchases of small amounts of food items and other consumables.

Retailers also provide sales outlets closer to consumers than would be typically provided by wholesalers and manufacturers. This is most clear with the suburban corner store located close to the home of consumers, but also in shopping precincts where retail outlets may cluster and thereby reduce the transport costs of consumers moving between multiple sales outlets.

Retailers aim to operate at times of the day convenient to consumers and can theoretically program their times of opening to meet consumer needs and demands (for example, opening 7 days a week or 24 hours a day). However, retail opening hours are more flexible in some jurisdictions compared to others, due to regulatory restrictions (chapter 10).

#### *Providing a market discovery mechanism*

Consumers face search costs in acquiring and assessing information about the features of new products entering the marketplace, and indeed in knowing that new products are available for purchase. These costs can include out of pocket expenses for finding or purchasing comparative information or the opportunity cost of the time taken to physically move between sales outlets. While buyers may also not have the skills or inclination to fully assess the relative features of new products, sellers also face search costs in identifying potential buyers and encouraging product purchases (through market research and advertising, for example).

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Retailers can provide a market discovery mechanism by searching out and supplying new products, new models of existing products or the latest fashions in products. They can stimulate demand for products through advertising and provide feedback to manufacturers regarding changing consumer interest in their products. Retailers also allow consumers to compare the prices of products more easily by displaying them in the same retail space.

#### *Other services provided by retailers*

Retailers provide after sales service if difficulties arise in the operation of the product and can be the point of contact in servicing and warranty issues.

Retailers can also facilitate consumer purchases of products by providing or arranging financial services. These can include lay-by arrangements, shopper cards and loan/credit arrangements with financial institutions.

#### *The role of retailers is changing*

While retailers have traditionally provided an intermediation role between manufacturers/wholesalers and consumers, this does not necessarily have to be the case anymore. For example, manufacturers/wholesalers can sell directly to consumers and bypass retailers (a process known as ‘disintermediation’), or retailers can replace existing external manufacturers/wholesalers by internalising those functions (a process known as ‘vertical integration’). In fact, no longer is the supply chain of goods necessarily sequential; instead, the distribution function of retail goods is reflecting a diverse ‘value network’ in which products reach consumers through various pathways.

The roles that retailers play change over time as the landscape in which they operate evolves. That is, as the character and nature of retail changes, so too does the function of retailers, and this has indeed been reflected in the development of the Australian and international retail industry over the last century or so.

## **2.2 How has the retail industry developed in Australia?**

The character and nature of retail in Australia has evolved considerably — driven by technological changes that range from the use of plate glass windows to aid goods display, inspection and price comparison in the early 19<sup>th</sup> century, to the advent of the internet in recent times which effectively provides a similar consumer service. In addition to continually adapting to emergent technologies, Australian

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retail has also responded to changing consumer preferences, competitive pressures and other social and economic forces.

Australian retail has historically been exposed to many international influences. Indeed, the evolution of Australia's retail industry has been closely linked with major retailing developments abroad — be it the embrace of new technological advances, to retail innovations adapted for Australian conditions. Its history of innovations and advances also suggests a pattern of gradual uptake from earlier international movers, generally due to our relatively small and geographically isolated market, before significant change is embraced. The Retail Traders' Association of Western Australia describes the Australian retail market:

... characterised by initially a slow acceptance/take up of new products/technology, but once accepted, the time to market saturation (or beyond) is extremely quick. (sub. 80, p. 5)

## **The early years**

Driven by technological and societal changes in the early years, the Australian retail scene by the beginning of the 20<sup>th</sup> century was largely characterised by high street retailing and a dominant department store model (box 2.1). The department store offered retailers a model of gaining economies of scale and spreading overheads, such as administration and brand advertising, over numerous product ranges — in effect finding efficiencies which in turn provided cheaper goods for consumers.

After the Second World War, a new major form of retailing emerged. In response to the rapid population growth in suburban areas and the significant increase in car ownership — more than trebling in Australia between 1947 and 1971 — there became a need and a possibility for shopping centres to move away from central business districts and expand into suburban areas (Hutson 1999; Spearitt 1995).

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## Box 2.1 The beginnings of Australian retailing

Modern retailing in Australia evolved from traditional markets and fairs and, by the early 1800s, this was supplemented by door to door peddlers and general stores. By the mid 1800s, specialist retailers emerged in response to increased urbanisation, higher living standards and increased quantities of manufactured goods. In an era before refrigeration and motor vehicles, such stores were located either in the central business district or clustered along main streets and street corners within walking distance of where people lived.

### The humble corner shop

The corner shop in an Australian community was a meeting place for people in addition to being a place to buy goods. Before the advent of convenience stores and big box supermarkets, these traditional shops played an important role in Australia's shopping history:

For regular customers, a corner shop is much more than bricks and mortar ... like hairdressers' or barbers' shops, the local butchers' or greengrocer shops ... that air of familiarity, the habits of a lifetime and the traditional ways of doing things, are part of a community's less tangible heritage. (McCann 2002, pp. 29-31)

As the design of windows and displays became more elaborate as retailers sought to draw customers into their stores, enclosed shopping streets or arcades emerged in capital cities. In line with the technological progress of the time, retailers were quick to use plate glass in windows and gas lights for illumination to enable goods to be displayed more easily to pedestrian traffic.

### The rise of the department store and high street retailing

A major change to retailing both in Australia and overseas was the emergence of the department store. By the 1870s, following the establishment of department stores in Europe and the United States, Australian soft goods retailers and drapers began to organise their stock into departments.

These stores, typically housed in multi-storey buildings, came to dominate the Australian retail landscape by the beginning of the 20<sup>th</sup> century. They utilised hydraulic lifts and electric escalators to move consumers around a vast range of merchandise, and provided entertaining window displays, in-house attractions, dining rooms and credit services.

It was only the city centres served by public transport that could attract adequate numbers of consumers to maintain such stores, and thus central business districts in Australian capital cities dominated the retail landscape ('high street retailing') as the premier shopping destinations until after the Second World War.

Sources: Davison (year unknown); McCann (2002); Webber et al. (2003).

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### *The Australian shopping mall*

The shopping mall is perhaps the most iconic and ubiquitous example of the modern retail establishment. The concept of the modern shopping mall originated in the United States in the early 20<sup>th</sup> century, when some department stores moved into the suburbs and outdoor ‘drive-in’ malls and strips of shops began to appear.<sup>1</sup> In trying to achieve a shopping format which balanced the relationship between ‘customer, car and shop’, a myriad of shopping centre designs were conceived across many American states by the 1940s (Hutson 1999, p. 20).

Australia was keen to embrace the new model. Australia’s first ‘drive-in’ mall or shopping centre opened in Chermside, Brisbane in 1957, followed six months later with a similar centre in Ryde, Sydney, and then in Chadstone, Melbourne in 1960. The world’s first enclosed and climate-controlled shopping mall, Southdale Centre, was opened in 1956 in Minneapolis in the United States and its concept of a suburban-focused, car-friendly and self-contained meeting spot became the preferred mode of shopping for consumers around the world.

Marketed for their size and convenience in providing major retailers and specialty stores under the one roof, and with the major attraction of ample and usually free car parking, shopping centres soon drew customers away from main street retailers and the central business districts, and drove retailing into the suburbs (Webber et al. 2003).<sup>2</sup> As shopping centres evolved, leisure and entertainment features for customers and integration with the community also become common features of the model (Myer, sub. 88). Shopping centres in Australia have grown and changed in response to consumer, retailer and community needs:

... innovations include the introduction into shopping centres of supermarkets, discount department stores, fresh food, entertainment and leisure precincts, centre courts for community activities, concierge facilities and upmarket restaurants ... bus and transport interchanges, libraries, child care, community facilities and other improvements to the public domain. (Shopping Centre Council of Australia, sub. 67, p. 6)

While the first mega malls were built to be shopping destinations, entertainment and food outlets could be their saving grace, with the retail industry still reeling from a drop in sales since the global financial crisis. (Lee 2011, p. 1)

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<sup>1</sup> While the origins of the shopping mall can be linked to periods as early as the 17<sup>th</sup> century with markets and bazaars, which also saw several shops located in one area, the concept of the ‘modern shopping mall’ refers to the format which was driven by suburban growth and car ownership — predominantly originating in the United States in the early 20<sup>th</sup> century.

<sup>2</sup> Since the 1990s, there has been something of a renaissance in high street shopping in inner city areas, driven by gentrification (renovation and remodelling of existing dwellings) and redevelopment (large scale urban infill projects on previous industrial sites) in some areas.

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## Innovations in Australian retail

As the American import of the shopping mall transformed Australia's retail scene, so too did a number of other innovations which followed — in terms of new technologies, retail formats, business strategies and business types — adding variety and change to Australian retail as it evolved over the decades (Australian National Retailers Association, sub. 91). Most of these significant developments in Australian retail had overseas precedents and have since become embedded in today's retailing environment. These developments also had implications for the level of productivity and competitiveness of the retail industry.

### *Self service*

By the latter part of the 20<sup>th</sup> century, self service in retail — particularly in grocery shopping — became widespread in Australia. This model of retail engaged consumers in their shopping experience, by allowing them to select their desired goods from shelves and refrigerated display cabinets, and then queue at a checkout to pay for them. While commonplace today, this development was a significant change from the previous service model in which the grocer would select the goods that consumers wanted from behind a counter (Kingston 1994; McCann 2002).

The notion of self service has advanced further in recent times, with the adoption of more user directed technology, particularly in the form of self checkouts in grocery and other retail stores.<sup>3</sup> Driven by consumer preferences for more control and convenience over their shopping experience, coupled with advancements in technology and cost advantages for retailers, self checkouts enable consumers to scan, weigh and pay for their goods (via cash credit or debit cards), as well as use other services such as 'cash out' and mobile phone recharges that a staffed checkout would normally offer.

Indeed, in a survey of consumers in five countries — Australia, United States, United Kingdom, India and Canada — NCR Corporation (the leading provider of self service technology, including to Coles and Woolworths) found that Australians were embracing self checkouts at more than double the rate of their European and American counterparts (Antill Magazine 2010). However, this relatively high adoption of self service technology may be to 'catch up' to other countries, with Palmer (2008) noting Australian retailers' relatively slow uptake of such technology:

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<sup>3</sup> Self service is not exclusive to retail. Other industries have also embraced self service technology in their customer operations. Examples include self service petrol stations, automated teller machines (ATMs) for banks and self check-in kiosks for airlines.

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Supermarkets worldwide have embraced self-checkout machines with fervour, but Australia has been relatively slow to react — especially when you consider that a quarter of US grocery chains had tested self-checkouts by 2003. (p. 1)

While self checkouts have reduced the need for some staff (though a staff member is usually on hand to help customers to use the machines), their purpose is in providing an alternative, potentially faster check out experience for those customers with few items. Woolworths also contend that the machines balance the flow of customers during peak times and that traditional checkouts are still preferred by customers with a large basket of goods (Miletic 2008).

### *Franchising*

Modern franchising originated in the United States in the 1950s with the emergence of fast food chains, and the model began to appear in Australian retail in the late 1960s and early 1970s. Today, franchising is firmly part of the Australian retail landscape, with surveys of Australian franchising indicating that around 28 per cent of franchises are in the retail industry (Frazer, Weaven and Wright 2008).

Franchising is a business ownership model in which the franchisor/owner grants permission for franchisees to open a business (after an initial fee and ongoing royalties) under the franchise brand name. Rather than starting a business from scratch, the business design, advertising and promotion strategies, and supply networks have already been established for franchisees, as well as exclusive territory rights. Some examples in Australia include 7-Eleven convenience stores, book retailer Dymocks and retail chain Harvey Norman.

In addition to expanding operations and reach domestically, franchising also allows a retailer a low capital cost means of entering another country's market — benefiting through local knowledge of franchisees (Harvey Norman as a franchisor for stores in Asia and Europe is an example of this). However, according to CB Richard Ellis, franchising as a means to globalise has become less prevalent in mature retail markets such as Australia's (with around 9 per cent of international retailers using the franchise model in Australia in 2010) — similar to the United States (6 per cent) and the United Kingdom (8 per cent) (CBRE 2011b). Instead, new franchising strategies in Australia have developed, such as 'retail co-branding' — where two or more franchised brands join to offer a combined retail offering at a single location — which can be seen with partnerships between BP and Wild Bean, BP and McDonald's and (the now closed) Borders and Gloria Jeans (Wright 2008).

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### *Private equity*

Investments by private equity firms involve aiming to maximise performance and increase company returns through a range of initiatives (for example, through expansion, cost reductions, leveraged balanced sheets, new management or product development), before selling the company at a higher value. Private equity is invested in a range of businesses, including retail. In Australia, Barbeques Galore, Repco and Godfreys are retailers currently under private equity ownership. Myer and Kathmandu are examples of retailers that have been publicly listed following private equity ownership.

Like franchising, private equity is another form of ownership and its role in the retail industry has been highlighted in recent times due to some high-profile collapses — the clothing and footwear group Colorado and book and stationery retailer REDgroup (box 2.2). Both were placed in administration in 2011 after enduring financial difficulties (Thomson 2011).

#### **Box 2.2 The collapse of Colorado and REDgroup**

While the collapse of Colorado and REDgroup has been attributed, to some extent, to the ownership model itself (because of poor management and debt obligations), as well as other factors such as the parallel importation restrictions on books and online competition (REDgroup), prevailing economic conditions and consumer confidence are also considered significant contributory factors:

That consumer conservatism has been reflected, not just in the collapses of Colorado and RedGroup ... but in the performance of other general merchandise and fashion retailers. Put that broader economic environment together with excessive levels of debt and poor management and all the ingredients for an implosion are in place. (Bartholomeusz 2011, p. 1)

In its submission, REDgroup stated that the type of ownership model was minor in impacting on Australian retailers and provided examples of other retailers, under other ownership business models, experiencing difficulties in the current retail climate:

Private Equity ownership is one of many ownership models available to retailers ... we argue that it is the structural economic conditions that are impacting retail business in Australia far in advance of ownership models ... other discretionary retail companies under public ownership structures have come under significant pressure ... not to mention countless small businesses. (sub. 89, p. 11)

### *Big box retailing*

From the 1990s, big box or megastore retailing emerged in Australia. These stores typically occupy large floor space in single storey buildings, provide large amounts of parking and derive profits from high turnover, low prices and low costs — focusing on high volumes and economies of scale rather than large mark-ups. Their

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relative scale to their traditional retail rivals has also seen such stores become known as ‘category killers’. This model was keenly embraced and replicated by Australia’s largest retailers following its emergence in the United States and Europe.

Coles Myer introduced Officeworks in 1994 (based in part on American big box retailers Office Depot and Staples) while Wesfarmers launched Bunnings Warehouses in the same year (based in part on the American big box retailer Home Depot) (Sammartino 2006). Recently, Woolworths and US-based Lowe’s announced that in late 2011 they would open their own big box ‘Masters’ hardware stores to compete with Bunnings (McIntyre 2011). Other examples of big box retailers in Australia include Dan Murphy’s liquor stores, whitegoods retailer Good Guys, homewares retailer IKEA and wholesaler Costco.

The big box retailing format in Australia is expected to experience significant growth in the future, with IBISWorld analysts predicting more than 300 big box retailers generating \$24 billion a year by 2015 — accounting for 9 per cent of total retail industry revenue (IBISWorld 2010). The slowing of big box retailer expansion (because of limited opportunities for further growth) in the United States is also considered a possible contributor to Australia’s predicted big box rise as these retailers seek offshore opportunities to continue their growth path.

### *Private labels*

Private labels are goods which are sold exclusively by a retailer and generally offer a cheaper alternative to ‘branded’ goods. For some time, more price-conscious consumers have been embracing these substitutes, and with substantial improvements in the quality of some private labels — with some aiming to match the quality of premium brands — there has been a surge in popularity and sales of these products in recent years in Australia and internationally.

According to a Nielsen global survey of over 27 000 consumers in 53 countries, more than half of the respondents stated that they purchased private label goods during the economic downturn and 91 per cent believed that they would continue to do so even when the economy improved (2011b). In Australia, private label brands are commonly seen in supermarkets such as Coles and Woolworths, which also carry branded goods, and Aldi which is virtually exclusively a private label retailer. Almost 25 per cent of the share of supermarket sales were attributed to private label brands in the September 2009 quarter (Gettler 2011), but they can also be found in non-grocery sectors. For example, IKEA and Zara are considered private label retailers.

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From a retailer's perspective, the advantages of private labels as a business strategy are:

- the potential for higher profit margins (estimated to be about 2 percentage points higher than on branded goods)
- more control over product design and marketing
- the potential for more consumer loyalty to the retailer
- to offset private label competition from rivals (Gettler 2011; Rogut 2007).

Indeed in the Australian grocery retail sector, a significant increase in the use of private labels was seen in direct response to the entrance of major private label retailer Aldi in 2001 (box 2.3).

### **Box 2.3 Aldi pushed surge in private label offerings**

Preparing for the arrival of major private label retailer Aldi into the Australian grocery market, both Woolworths and Coles launched a range of private label goods:

Woolworths has been quietly rolling out a range of premium private label grocery products in a strategy aimed at countering one of Aldi's major strengths in its early days of launch in Australia. (p. 14)

Woolworths initiated a range of more than 160 private label products in preparation for Aldi's arrival. In 2001, Woolworths stated that the products:

... were developed to fill a void in Woolworth's private label offer as well as in response to the entry of the German discounter Aldi into the Australian market. (p. 14)

Similarly, Coles reintroduced Farmland for its goods and grocery line as well as many other new private label goods in response to Aldi, including imitating Aldi's style of packaging and range, to compete with the global retailer.

*Source:* Coriolis Research (2004).

## **The globalisation of Australian retail**

While many of the retail innovations discussed above indicate early international influences on Australia's changing retail landscape, the more significant 'globalisation' of Australian retail — and a signal of a more integrated global economy — has been more distinctly seen with the recent rise in retailers moving across geographic borders and the advent of the internet and the digital age.

Traditionally retail has been regarded as a domestic industry that has been largely shielded from the impacts of globalisation. But technology has changed that; retail has gone global. (Australian National Retailers Association, sub. 91, p. 12)

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### *International retailers on Australian shores*

Historically, Australia has not been seen as a particularly attractive environment for overseas retailers to enter, compared to other regions. Indeed for a significant time, retail was not seen as a business model lending itself to capture value from international expansion. The geographic position of Australia and the small size of its market and physical distance from other markets produced a natural barrier. This together with other barriers to entry into the local retail market created an isolated market — in terms of international entrants — for much of the 20<sup>th</sup> century:

No international entrant could utilise advantages in purchasing from existing networks of suppliers to outmanoeuvre incumbents because many products were purchased from protected domestic producers. (Sammartino 2006, p. 9)

Sammartino (2006) states that this led to a highly concentrated retail industry in Australia, particularly in the supermarket and grocery sector. While a number of overseas retailers attempted to establish in the Australian market (for example, American department store Sears Roebuck and Japanese department store Daimaru) and proved financially unviable, Aldi's entrance in 2001 signalled a significant overseas competitor in the Australian market:

Unencumbered by share market scrutiny, this privately-held entity appeared to have the deep pockets necessary to take on the big duopolists. (Sammartino 2006, p. 10)

However, international speciality retailers have had a growing presence in the Australian market. Of the top global retailers operating in Australia in 2009, the majority are in specialty areas, such as clothing, luxury and sporting goods, books and music (table 2.1).

In recent years, many high-profile global retailers have entered, or are planning to enter, the Australian market — such as Costco and Gap from America, fashion retailers Zara from Spain (box 2.4) and Uniqlo from Japan. The attraction of Australia as a retail investment location has been bolstered somewhat given our relatively robust economic performance during the global economic downturn (CBRE 2011a; Stafford 2010). CB Richard Ellis, in its survey of more than 300 global retailers in 73 countries, attributed new interest from North American retailers to attractive investment sites of new and modern shopping areas such as Myer Emporium in Melbourne and Westfield in Sydney. In addition:

... the transparency of the Australian market, population growth prospects and relatively strong economic fundamentals had been among the draw cards for US retailers. (CBRE 2011a, p. 2)

**Table 2.1 Large retailers currently operating in Australia by global ranking**

The top 250 retail firms in 2009

<i>Firm (and Australian brand name(s) if different)</i>	<i>Global rank</i>	<i>No. of countries operating</i>	<i>Country of origin</i>	<i>Format<sup>a</sup></i>	<i>No. of Australian stores (approx.)</i>	<i>Date of entry</i>
Aldi Einkauf GmbH & Co. oHG (Aldi)	8	18	Germany	F	200	2001
Costco	9	9	U.S.	F	3	2009
Seven & i Holdings (7-Eleven)	16	18	Japan	F	400	1977
Woolworths (Woolworths, Big W, Tandy, Dick Smith Electronics, Dan Murphy)	20	2	Australia	F,G,S	1700	1924
Wesfarmers (Coles, Bi-Lo, Target, Kmart, Officeworks, Harris Technology, Bunnings)	23	2	Australia	F,G,S	1900	1914
IKEA	30	38	Sweden	S	5	1975
PPR (Gucci, Yves Saint Laurent, Puma etc.)	44	84	France	S	na	na
Inditex (Zara)	50	74	Spain	S	2	2011
The Gap	59	25	U.S.	S	2	2010
LVMH Moët Hennessy-Louis Vuitton	61	79	France	S	300	2003
Toys R Us	63	35	U.S.	S	40	1993
Limited Brands (Victoria's Secret, La Senza)	102	45	U.S.	S	6	na
Apple	133	9	U.S.	S	10	2008
Foot Locker	162	28	U.S.	S	82	1989
Luxottica (OPSM, Sunglass Hut, Laubman & Pank, Budget Eyewear, Watch Station)	179	25	Italy	S	300	2003
Blockbuster	191	19	U.S.	S	404	1991
HMV	231	7	U.K.	S	31	1989
Coach	238	6	U.S.	S	7	na
Metcash (IGA, Jewel, Campbells Cash & Carry)	245	5	South Africa	F	na	1988

<sup>a</sup> F = food, G = general, S = specialist retailing. **na** Not available.

Sources: Deloitte (2011); Sammartino (2006); various retailer websites.

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## Box 2.4 Zara enters the Australian market

The arrival of Zara in April 2011 saw many Australian shoppers visiting the Spanish fashion retailer:

Customers repeatedly cleared the shelves of Zara when it opened on Wednesday, with many queuing outside for hours to get in. Within three minutes of the fast-fashion icon opening at 9am, 80 per cent of the stock had been sold. (Lewington and Speranza 2011, p. 1)

Many commentators heralded Zara's entrance as a spark for competition among local fashion brand retailers such as Sportsgirl, Witchery and Country Road. Aside from price point competition, Zara's supply chain efficiency and quick stock inventory turns are considered world-class.

Through its vertically integrated brand, Zara controls more stages of the production and distribution process for a seamless delivery of its goods, with orders for new products made regularly and able to arrive in Australia within three weeks. (Vertical integration of brands is also utilised by retailers such as Kathmandu, Tiffany & Co. and Apple). The chief executive of Witchery stated that:

Zara is a fast-fashion label — they will go for volume and price ... without a doubt, Zara will take market share from other local brands. (Ooi 2011, p. 1)

The founder of fashion retailer Cue acknowledged the high profile of the new competitor:

Zara is the best fashion company in the world and will keep the locals on their toes. We are not worried about competition ... we have been in business for 44 years and have a strong following. (LaFrenz 2011, p. 18)

When international retailers enter the Australian market, particularly when they offer superior business models, this not only provides Australian consumers with a greater variety of products, but it also compels Australian retailers to adapt and improve their operations:

... increased competition [by international retailers] is welcomed by existing local retailers but requires them to respond to the added competitive pressures by ensuring they are meeting their customers' needs in terms of both price and service. (Australian National Retailers Association, sub. 91, p. 12)

Indeed, enhanced competition from physical or virtual retailers helps ensure that the local industry remains flexible, efficient and relevant to consumers.

*Source:* LaFrenz, Mitchell and Cleary (2011).

However, Australia remains a small player in the global retail scene, and is ranked 31<sup>st</sup> out of the 73 countries in terms of major international retailer presence. The lack of attractive investment locations and high occupancy costs by global standards have been considered contributors to this:

Despite the recent focus of international retailers on the Pacific Region, there appears to be a long way to go before Australia can be considered a major player in the expansion of global retail brands. (CBRE 2011a, p. 1)

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### *Australian retailers venturing abroad*

Reflecting the geographically isolated marketplace and associated inward looking business strategy of the retail industry in general, few Australian retailers have looked beyond the local market to expand their operations. The majority of large Australian retailers that have an international strategy tend to be focused on the closer New Zealand and Asian markets — rather than those in Europe or the United States (with the exception of Harvey Norman, which has also expanded into the European market). Wesfarmers and Woolworths, for example, were ranked in the top 250 retailers in the world in terms of sales revenue in 2010, but only have retail operations in Australia and New Zealand (The Australian 2011).<sup>4</sup>

Reluctance to venture and expand operations abroad, however, is not exclusive to Australian retailers. In fact, while the vast majority of large retailers around the world have operations in countries and regions beyond their domicile, expansion is not always extensive. Of the top 250 global retailers in 2009, for example, only 117 of them had store presence in more than two countries (Deloitte 2011; Nordas, Gelosi Grosso and Pinali 2008).

Although there has been plenty of globalization, the industry remains far more parochial than others such as consumer products, hospitality, telecommunications, and entertainment ... It is the industry that maintains the closest and more personal relationship with consumers ... and establishing a successful personal relationship is far more challenging in an alien culture. (Deloitte 2011, p. 9).

There are several potential difficulties in international retail expansion, and many factors which retailers need to consider before pursuing a transnational strategy (Wrigley and Lowe 2010). These include:

- institutional, cultural and organisational barriers: in order to be competitive in a new market, retailers have to be able to adapt to local consumer preferences, business practices, supply networks and other dimensions of ‘territorial embeddedness’
- regulatory barriers: retailers need to comply with a local country’s laws which relate to retailing, such as zoning and planning, retail tenancy and opening hours.

### *Online retailing*

The internet has been a revolutionary technological innovation for many people and for many facets of everyday life. Indeed the widespread use of the internet has given

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<sup>4</sup> A number of Australian specialty retailers, however, have expanded abroad and successfully adapted their business model to an international market, including Barbeques Galore, Cash Converters and OPSM (Sammartino 2006).

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rise to the most recent and remarked upon addition to the retail landscape — online shopping.

The nature of retail for both consumers and retailers has changed because of the internet and the associated developments in digital technology (Council of Small Business, sub. 74; Photo Marketing Association, sub. 40). The functions of retailers and the value they offer to consumers have shifted, with the nature of selling changing and enhanced pressures to innovate to meet new consumer preferences and expectations.

### *Impact on consumers*

The internet provides consumers with more control over their shopping experience. Search costs for goods are reduced as the internet enables consumers to undertake a greater range of price and quality comparisons with minimal effort, in contrast to physically visiting multiple retailers.

Many consumers use the internet as a research tool but still make the purchase in person. This is possible through manufacturer and retailer websites, as well as the proliferation of websites providing online reviews and customer discussion forums. This in turn enables consumers to access greater price comparison information from which to make more informed buying decisions (Access Economics 2010). For example, the Nielsen's 2010-2011 Australian Online Consumer Report found that almost three quarters (73 per cent) of the 5000 Australians sampled read other consumers' opinions about products and brands via social media, close to half (43 per cent) discussed or commented on brands, products or services online and one third (33 per cent) posted online reviews (Nielsen 2011a).

Online shopping provides greater flexibility and convenience for consumers as to when and where they can shop, as they are not constrained by trading hours or geography. And, perhaps the greatest impact on consumers has been the significantly wider range of goods available to Australian consumers because of the expanded global marketplace and the cheaper prices for a range of goods given enhanced retail competition.

Alongside the attractiveness of online shopping, the rise of more technologically savvy consumers has also led to new and innovative ways of shopping. These include:

- group shopping — where online shoppers show their interest for a particular deal on a website, and if a minimum number of other shoppers do so as well, the cost-saving deal goes ahead. Examples of these buying group websites include: [cudo.com.au](http://cudo.com.au), [scoopon.com.au](http://scoopon.com.au), and [jumponit.com](http://jumponit.com)

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- mobile commerce or ‘m-commerce’ — where mobile devices are increasingly becoming part of the shopping experience for many consumers (chapter 4). The rise in Smartphone technology use has made m-commerce increasingly popular:

With the rapid adoption of web enabled mobile devices fuelling consumer demand, Smartphones now account for 63 per cent of the total handset market and 68 per cent of Australians plan to use mobile devices for transactions and payments in the near future. (Dods 2011, p. 1)

### *Impact on retailers — changing functions*

Australian retailers not only have to compete in the local market, but increasingly with retailers from around Australia and the world. The embrace of the digital era has produced a new breed of retailers in the market — ‘pure play’ online retailers. Indeed, a physical shopfront is no longer necessary to engage with consumers. Whether online retailers are headquartered abroad (such as perfume, skincare and makeup retailer StrawberryNet and fashion retailer Asos) or in Australia (online department store Deals Direct and online bookstore Fishpond, for example), these retailers have significantly less overhead costs and are appealing to some consumers from both a price and convenience standpoint.

While some sectors of retail will face more competitive pressures from online retailers than others, the popularity of online shopping and the use of the internet in the shopping experience has certainly changed the nature of retailing, most likely in a lasting way, as traditional retailer functions evolve.

Where, traditionally, retailers would act as the convenient conduit between global suppliers or manufacturers and consumers, these channels are becoming more diverse as consumers can choose other avenues to purchase goods (sometimes direct from the manufacturer and through disintermediation) (Johnston et al. 2000). Where, traditionally, retailers would provide a market discovery mechanism for consumers, the internet now provides an abundance of product guides and a level of transparency that can quickly inform a consumer.

Dods (2011) quotes the Australian Retailers Association as being cognisant of the altering effect the advent of internet shopping will have on the nature of retailing:

The retail industry is evolving and retailers must move with it to both remain competitive and meet shifting consumer demands. Put simply, retailers must have a presence wherever their customers are – be they in store, online or on their mobile phones. (p. 1)

Adapting to the growing consumer preference for online shopping, new models of bricks and mortar retailing have gradually emerged in Australian retail. However,

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the acceptance and embrace of online shopping and the internet as a business strategy — much like some other technological advances in Australian retail history — has been purported to be relatively slow for Australian bricks and mortar stores and behind their United States and United Kingdom counterparts (Bullas 2009; Hitchen 2007). Kelvin Morton compared the sophisticated online developments of retailers in the United States relative to Australia:

In Australia, many of the major retailers have a highly immature online sales capability, if they even have one at all ... When I recently did some consulting work for a major Australian retailer, I found their systems and processes and general mindset to be approx. 5 years behind the work I was doing in the US – 5 years ago ... Worse still, is that they seem to have no strategically significant plan to try and close the gap. (sub. DR131, p. 3)

On the other hand, the Australian National Retailers Association argue that it has been Australian consumers who have been slow to take up online shopping, quoting David Jones' foray into online selling in 2000 (and subsequent withdrawal in 2003) as an example:

Indeed, many early providers of online shopping websites in Australia found this was not what consumers wanted and it failed to deliver the expected returns. (sub. 91, p. 13)

Nonetheless, Australian bricks and mortar retailers have increasingly embraced online selling in recent years in line with rising positive consumer attitudes — though not necessarily as a means of achieving growth and increased profits, but as a defensive tactic to maintain market share. As such, there have been moves by traditional retailers into multi-channel operations — having an online presence as well as a bricks and mortar shopfront (also known as 'clicks and mortar' retailers) — examples include JB Hi-Fi, Officeworks and BigW. Harvey Norman, hardly seen as a first-mover in this area, has also recently launched an online retail store (providing product information and prices, but with no transaction capacity at this stage). Booth (2011) quoted Gerry Harvey:

By this time next year you'll see Harvey Norman with a pretty sizeable internet presence. My heart's beating very strongly on whether we make any money from it ... I haven't got any choice. (p. 1)

Models in which consumers are able to make a purchase on the retailer's online website, and then retrieve the goods from the bricks and mortar store (also known as 'click and pick' retailers) or delivered to consumers' homes are also emerging. Coles has been trialling an 'online order and pick-up' scheme as a convenient and more efficient shopping trip for consumers since May 2011 and Woolworths is expected to rollout their similar service in August 2011 (Kale 2011; Stafford 2011). Indeed, a few pure play online grocery retailers operate as a time saver and convenient way of shopping for consumers in Australia (for example, Groceries 4 U

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and Only Australian Groceries) and internationally (such as major British online grocery retailer Ocado and Amazon UK). Another development that some bricks and mortar retailers face, because of online shopping, has been the separation of selling a good and providing service for a good (box 2.5). Trends and issues relating to online retailing are discussed in more detail in chapter 4.

**Box 2.5 The separation of purchasing a ‘good’ and purchasing the ‘service’**

The increased transparency and information portal the internet provides for consumers has meant that, for some goods, traditional retailer services can be replaced by consumers themselves — giving retailers a new role focused on service provision.

For example, as consumers purchase items from online retailers (whether they be from overseas or within Australia), they may opt to repair, assemble or service their good at a bricks and mortar store. Several submissions indicated this tendency, particularly in the area of bicycle retailing. Yarra Valley Cycles in Melbourne stated:

... we have not only accepted their decision to buy online, we have tried our best not to alienate those that still wish to visit our store by offering servicing and fitting of these parts (at least this way we are able to make some money on the labour portion of the purchase). (sub. 32, p. 1)

Blackman Bicycles in Sydney:

Approximately 10% of the people we serve each day are people coming into our establishment and wanting my staff to educate them on a product that they wish to purchase. That is, they want us to educate them to a level where they feel confident enough to go and buy the product on the internet. (sub. 52, p. 1)

Similarly, ForTheRiders bike shop in Brisbane described how often poorly assembled bicycle parts propelled online purchasers to return to their retail stores, after initially gathering information about models from their sales staff:

The potential customer is then armed with the type of personalised knowledge that is not readily available on the internet, and can comfortably purchase from one of our overseas online competitors ... It is only when the item breaks, or is incorrectly installed, that we see the same customer ... back for a repair or assistance. (sub. 55, p. 6)

Consumers are increasingly able to ‘free ride’ on store services — with no obligation to purchase — by browsing in store but then making the purchase online. According to a Daily Telegraph survey of 1000 people, 61 per cent revealed that they had tried a product in store but chose to purchase it afterwards online (presumably at a cheaper price). In response, to try to cover the cost of staff time spent with consumers, some bricks and mortar retailers have begun to charge consumers for their services by having ‘fitting fees’ for their goods (ski boots, for example), which is then deducted from the price of the good if the consumer makes the in-store purchase.

Sources: Bitá (2011); Jacob (2011).

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## Conclusion

Advancements in technology and other retail innovations, mostly overseas changes adapted to local conditions, have led to the nature of Australian retail changing dramatically over the past century or so. The latest chapter of this story of evolution is the rise of online shopping. This change is qualitatively different from past experiences because of its substantial impact on opening up the Australian retail market — competitors are not just down the street or in the next suburb, but are now national and international.

Indeed, segments of Australian retail are no longer protected by the ‘tyranny of distance’. Moreover, the internet has given rise to enhanced transparency for consumers as they can quickly become informed about products and pricing — comparing easily between retailers.

However, as with other developments in Australia’s retail history, the industry will respond to this significant change and evolve. While retailers and certain sectors of the industry will be challenged by online shopping as domestic and overseas competition increases, many should be able to respond effectively to this new environment and successful new entrants will also emerge.

The digital era and global retail marketplace have certainly provided some challenges and pressures to adapt and innovate to meet consumer tastes, but they have provided opportunities for the industry as well. As competition is enhanced, it is important that retailers have the flexibility to respond effectively to these changes and shifting consumer preferences for shopping. While there is an onus on retailers themselves to adjust to the changing retail landscape, from a public policy perspective, government can enhance competitiveness by ensuring retailer flexibility through changes to the regulatory environment in which they operate, including planning and zoning, shopping hours and workplace practices. These issues are addressed in later chapters of this report.

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### 3 The structure and performance of the retail industry

#### Key Points

- The retail industry is a significant contributor to the Australian economy, representing 4.1 per cent of GDP and 10.7 per cent of employment.
- The profit performance of the retail industry is varied — around 70 per cent of all retail businesses are making a profit and 28 per cent a loss. This is similar to the figure for all Australian industries in general. The average return on capital in the retail industry was 24 per cent in 2010, again broadly the same as the average for all industries. Larger businesses in retail are generally more profitable than smaller businesses with many of the largest businesses historically among the most profitable in the economy. The larger retailers in Australia would appear to have enjoyed better returns on capital than their overseas counterparts and have continued to do so since the global financial crisis.
- Growth in retail sales has been slow in recent years. While short-term or cyclical factors have contributed to this slowdown, the growth of retail sales has experienced a long-term slowdown due to changes in consumer buying habits. Consumers are choosing to spend a smaller share of their income on retail goods because over the recent past, they are saving more and they are spending greater shares of their expenditure on services such as finance, rent and education. Further, while there has been price deflation in some sub-categories of retail, overall, sales volumes have continued to grow.
- The level of productivity in the Australian retail industry is low compared to retail in other countries in Europe and North America. However, the growth rate of productivity in retail, over the past two decades, has been similar to the average rate for all industries in Australia. Retailers have achieved productivity growth by increasing the capital intensity of their operations, including through adopting information and communications technology. Furthermore, investments in big box retailing have also been a factor. These changes occurred earlier in the United States, and since then, US retailers have continued to achieve productivity growth by improving management and operations to make more effective use of labour and capital. These opportunities appear yet to be fully realised by most Australian retailers.

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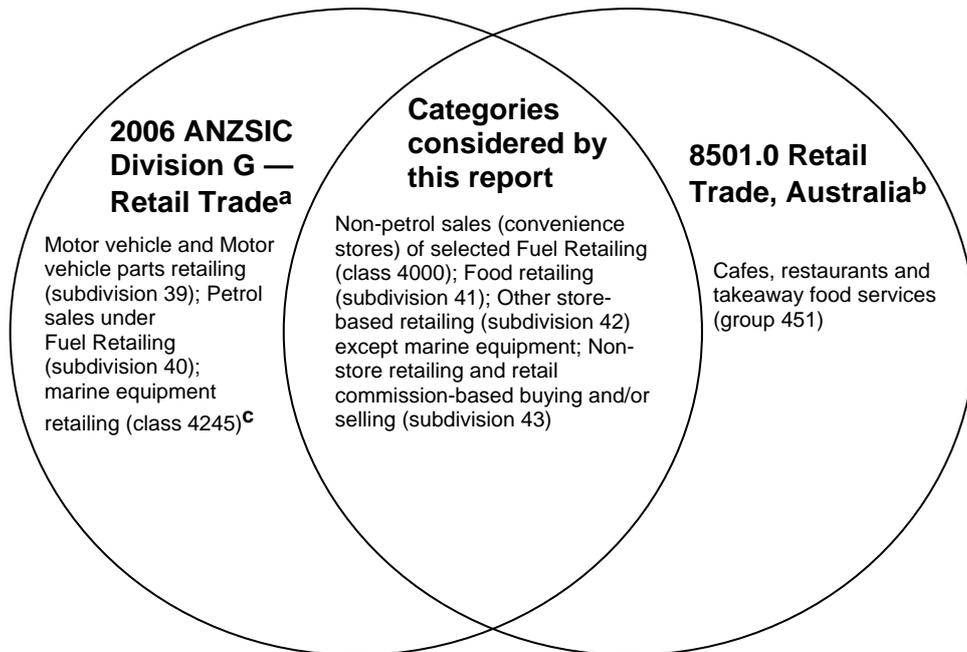
This chapter's snapshot of the retail industry, its sales performance, profitability and productivity, serves as a basis for the analysis in the following chapters of the challenges and opportunities facing the industry. It also sets the scene for the report's later discussion of the regulatory impediments which may be limiting the flexibility of the industry in responding to changing consumer preferences and in adopting innovations in the delivery of its services.

This chapter draws on various data sources from the ABS, which use the 2006 Australian and New Zealand Standard Industrial Classification (ANZSIC) definition of *Division G — Retail Trade*. As mentioned in chapter 1, motor vehicle and motor vehicle parts retailing (subdivision 39) and fuel retailing (subdivision 40) have been excluded from the statistical data presented in this chapter where practicable.

One of the ABS data catalogues used in this chapter is *Retail Trade, Australia* (Cat. no. 8501.0). This provides the most current data for retail turnover, but it includes only a selection of the subdivisions in Division G, as well as *Cafes, restaurants and takeaway food services* which falls under *ANZSIC Division H — Accommodation and Food Services*. In this data source, retail turnover is broken down into the following categories: food; household goods; clothing, footwear and personal accessory; department stores; other retailing; and cafes, restaurants and takeaway food services. When presenting and reporting data for retail turnover using this source, 'cafes, restaurants and takeaway food services' are excluded.

Figure 3.1 below shows the cross-over between the ANSZIC 2006 Division G and retail turnover as defined in *Retail Trade, Australia* 8501.0.

**Figure 3.1 Cross-over between the 2006 ANZSIC Division G and Retail Trade, Australia**



<sup>a</sup> The 2006 ANZSIC is used by the ABS in *Australian System of National Accounts*, Cat. no. 5204.0; *Labour Force Australia*, Cat. no. 6291.0; *Counts of Australian Businesses*, Cat. no. 8165.0; *Australian Industry*, Cat. no. 8155.0 and *Experimental Estimates of Industry Multifactor Productivity, Australia: Detailed Productivity Estimates*, Cat. no. 5260.0.55.002. When data from these sources are referred to in this report, motor vehicle and motor vehicle parts retailing (subdivision 39) and fuel retailing (subdivision 40) have been excluded, unless otherwise indicated. <sup>b</sup> When data from *Retail Trade, Australia*, Cat. no. 8501.0 are referred to in this report, cafes, restaurants and takeaway food services (group 451) have been excluded. <sup>c</sup> Marine equipment retailing class (4245) is also considered in this report.

Source: ABS (*Australian and New Zealand Standard Industrial Classification (ANZSIC) 2006 (Revision 1.0)*, Cat. no. 1292.0); ABS (*Retail Trade, Australia*, Cat. no. 8501.0).

### 3.1 A snapshot of the retail industry

#### Retailing makes a significant contribution to the economy

The retail industry is one of Australia's largest employers employing 1.2 million people or 10.7 per cent of the total working population in 2009-10. In that year, retail workers earned about \$32 billion in wages and salaries, or 6 per cent of the economy's total.

The retail industry also makes a significant contribution to economic output, contributing \$53 billion or over 4 per cent of GDP in 2009-10. However, it is a relatively small contributor to investment (table 3.1).

**Table 3.1 The contribution of Australian retail trade, 2009-10<sup>a</sup>**

	<i>Retail trade</i>	<i>Contribution to total</i>
		%
Gross value added (\$m)	53 259	4.1
Employment ('000s)	1 196	10.7
Wages and salaries (\$m)	32 276	5.9
Investment (\$m)	6 090	1.7
Capital stock (\$m)	62 131	1.5
Number of businesses (end 2008-09)	138 886	6.8

<sup>a</sup> Includes motor vehicles and motor vehicle parts retailing and fuel retailing.

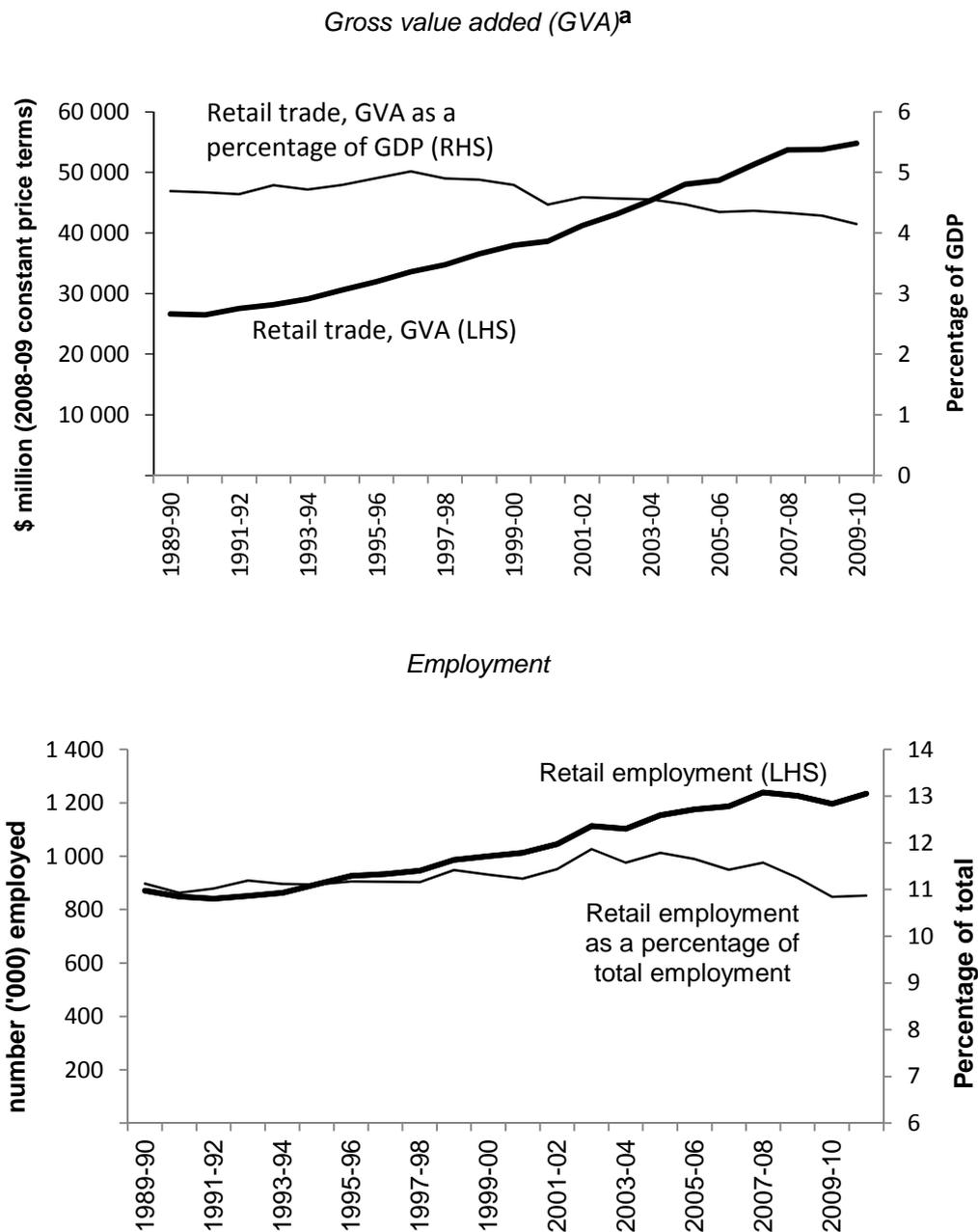
Source: ABS (*Australian System of National Accounts: gross fixed capital formation and capital stock*, Cat. no. 5204.0; *Labour Force, Australia*, Cat. no. 6291.0, *Counts of Australian Businesses*, Cat. no. 8165.0).

### **Retail industry share of GDP and of employment have been declining**

Although output has been steadily increasing in real terms in the retail industry over the last few decades, there has been a gradual decline in the sector's contribution to GDP. The industry's share of GDP fell from over 5 per cent in 1996-97 to 4.1 per cent in 2009-10 (figure 3.2).

Employment numbers in the retail industry have been steadily increasing — from 887 000 people in 1989-90 to almost 1.2 million people in 2009-10. However, in recent years the retail industry's share of total employment in the economy has been falling slightly. Figure 3.2 illustrates that the retail industry's share of total employment was relatively stable between 1989-90 and 2001-02. However, since 2002-03 it has fallen from a high of 12.1 per cent to a low of 10.7 per cent in 2009-10.

Figure 3.2 Trends in gross value added and employment in retail trade, 1990-01 to 2009-10



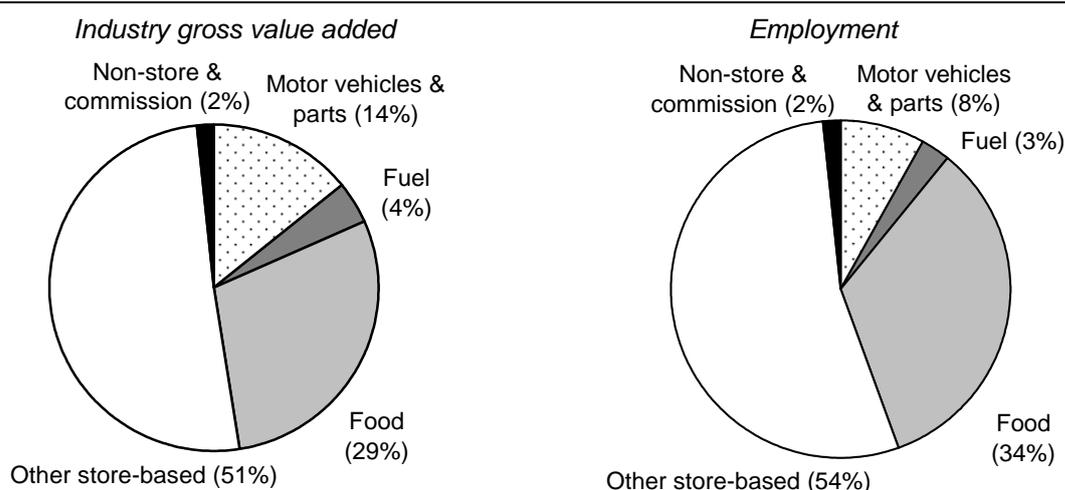
<sup>a</sup> Retail GVA is measured in chain volume, which removes price change effects from GVA in current prices.

Data source: ABS (Australian System of National Accounts, Cat. no. 5204.0 and Labour Force, Australia, Detailed, Cat. no. 6291.0).

## Sectoral contributions

The largest retailing subdivisions are *other store-based retailing* and *food retailing* (figure 3.3). Other store-based retailing includes furniture, floor coverings, houseware and textile goods; electrical and electronic goods; hardware, building and garden supplies; recreational goods; clothing, footwear and personal accessory, department stores and pharmaceutical and other store-based retailing. Non-store and commission-based retailing represents two per cent of retail sales and includes online ‘pure play’ retailing. However, it does not include all online retailing: if online sales make up a minor share of a multi-channel retailer, the ABS generally classifies the online sales of that retailer into one of the other subdivisions of retailing, which is most relevant to the primary activity of the retailer.

Figure 3.3 **Contributions to retail industry output and employment, 2009-10<sup>a</sup>**



<sup>a</sup> Due to rounding, percentages may not add to 100.

Data source: ABS (Australian Industry 2009-10, Cat. no. 8155.0).

## Employment

In 2008-09, about 60 per cent of businesses that the ABS classifies as retail businesses employed workers (ABS 2010b). Table 3.2 further breaks down employing retail businesses by the number of employees they engage. As can be seen from the table, most retail businesses are small businesses with almost half of employing businesses employing four or less workers. Conversely, the largest retailers (employing more than 50 workers) only represent four per cent of employing retail businesses.

**Table 3.2 Breakdown of employing businesses by workforce size, June 2009<sup>a</sup>**

	<i>Per cent of employing businesses which employ</i>			
	<i>1-4</i>	<i>5-19</i>	<i>20-49</i>	<i>50+</i>
	<i>%</i>	<i>%</i>	<i>%</i>	<i>%</i>
Agriculture, forestry and fishing	61	32	5	2
Mining	52	28	9	11
Manufacturing	45	35	13	8
Electricity, gas, water and waste services	58	26	9	7
Construction	72	22	4	2
Wholesale trade	54	32	9	5
<b>Retail trade<sup>b</sup></b>	49	37	9	4
Accommodation and food services	38	38	15	9
Transport, postal and warehousing	72	20	5	3
Information and telecommunications	64	21	8	7
Financial and insurance services	74	20	3	3
Rental, hiring and real estate services	59	31	8	3
Professional and scientific services	71	23	5	2
Administrative and support services	54	29	9	8
Public administration and safety	50	28	13	9
Education and training	52	31	10	8
Health care and social assistance	61	29	6	4
Arts and recreation services	54	31	10	6
Other services	63	31	4	1
<b>All industries</b>	61	28	7	4

<sup>a</sup> Due to rounding, percentages may not add to 100. Non-employing businesses are excluded. <sup>b</sup> Includes motor vehicles and motor vehicle parts and fuel retailing.

Source: ABS (*Counts of Australian Businesses*, Cat. no. 8165.0).

During 2008-09, the total number of businesses in Australia declined (table 3.3) by over 20 000, or around one per cent (ABS 2010b). This small net change in the stock of businesses hides a much higher gross entry and exit rate or flow of businesses into and out of the economy. Businesses in the retail industry had a slightly higher exit rate (15.8 per cent) and a slightly lower entry rate (13.4 per cent) than for businesses overall. This resulted in a slightly greater fall in the stock of businesses in retail of -2.4 per cent compared to that for the economy as a whole. These exit and entry rates suggest a dynamic industry — while many retailers are leaving the industry, others see it as attractive to enter.

**Table 3.3 Business numbers, exit and entry rates**

	2007-08			2008-09		
	Entry rate	Exit rate	Change in business count from start to end of year	Entry rate	Exit rate	Change in business count from start to end of year
	%	%	%	%	%	%
Agriculture, forestry and fishing	9.1	11.2	-2.0	8.9	10.7	-1.7
Mining	16.9	12.7	5.0	14.5	13.4	1.0
Manufacturing	10.7	13.3	-2.5	10.5	13.4	-3.0
Electricity, gas, water and waste services	15.0	14.1	-2.3	15.0	15.0	-0.1
Construction	15.8	16.3	-1.0	14.5	16.4	-1.9
Wholesale trade	13.2	14.5	-1.8	12.2	14.8	-2.6
<b>Retail trade</b>	<b>13.8</b>	<b>16.3</b>	<b>-1.9</b>	<b>13.4</b>	<b>15.8</b>	<b>-2.4</b>
Accommodation and food services	17.4	18.6	-0.4	16.8	18.1	-1.3
Transport, postal and warehousing	16.2	16.0	-0.3	15.7	16.3	-0.6
Information and telecommunications	16.5	18.0	-1.6	16.8	17.5	-0.7
Financial and insurance services	19.3	15.8	3.6	16.4	15.8	0.6
Rental, hiring and real estate services	14.1	12.1	2.1	10.7	12.4	-1.7
Professional, and scientific services	14.4	15.5	-1.0	14.4	15.3	-0.9
Administrative and support services	18.6	19.1	-1.3	18.9	19.5	-0.6
Public administration and safety	19.3	20.5	-2.4	19.4	21.3	-1.8
Education and training	16.7	16.9	-2.2	16.4	16.6	-0.2
Health care and social assistance	12.0	10.3	1.6	11.9	10.9	1.0
Arts and recreation services	15.3	18.6	-2.4	14.8	17.5	-2.7
Other services	14.7	15.9	-2.0	13.5	15.8	-2.2
Unknown	63.9	42.4	21.4	65.7	46.1	19.6
<b>All industries</b>	<b>15.3</b>	<b>15.3</b>	<b>-0.2</b>	<b>14.4</b>	<b>15.4</b>	<b>-1.0</b>

Source: ABS (Counts of Australian Businesses, Cat. no. 8165.0).

Overall, the decline in the number of businesses in the retail industry was broadly reflected throughout the retail subdivisions, but there were some differences.

Table 3.4 shows some disparate outcomes within different sectors in the retail industry. There was also a diversity of experience with employment levels across retail sectors.

**Table 3.4 Retail subdivisions: business summary statistics, 2008-09<sup>a</sup>**

	<i>Businesses end of year</i>	<i>Exit rate</i>	<i>Entry rate</i>	<i>Change, number of businesses</i>	<i>Employ 1-19<sup>b</sup></i>	<i>Employ 20+<sup>b</sup></i>
	(no.)	%	%	%	%	%
<b>Food retailing</b>	<b>26 209</b>	<b>15.6</b>	<b>13.3</b>	<b>-1.7</b>	<b>83</b>	<b>17</b>
Supermarket and grocery stores	9 681	15.5	15.0	-0.3	77	23
Specialised food	16 528	15.6	12.3	-2.4	87	13
<b>Other store-based retailing</b>	<b>88 845</b>	<b>15.0</b>	<b>12.7</b>	<b>-2.6</b>	<b>88</b>	<b>12</b>
Furniture, floor coverings, houseware, textiles	7 905	13.8	12.7	-1.8	91	9
Electrical and electronic goods	12 717	16.3	14.3	-1.5	86	14
Hardware, building and garden	9 207	11.7	9.7	-1.4	87	13
Recreational goods	12 845	13.9	10.6	-3.0	90	10
Clothing, footwear and personal accessory	17 194	16.7	15.8	-0.8	91	9
Department stores	192	n.a <sup>c</sup>	n.a	1.6	60	40
Pharmaceutical and other stores	28 785	15.3	12.1	-4.7	86	14
<b>Non-store and commission retailing</b>	<b>9 902</b>	<b>26.8</b>	<b>25.4</b>	<b>-1.8</b>	<b>95</b>	<b>5</b>
Non-store retailing	7 260	26.7	27.3	0.0	94	6
Retail commission-based buying and/or selling	2 642	26.9	20.7	-6.5	97	3
<b>Total retail</b>	<b>139 610</b>	<b>15.6</b>	<b>13.5</b>	<b>-2.4</b>	<b>87</b>	<b>13</b>

<sup>a</sup> The sum of industry subdivisions do not equal the total published in the catalogue as the ABS adjusts the level of aggregation of data for confidentiality reasons. <sup>b</sup> The breakdown of retail businesses by employment size excludes non-employing businesses. <sup>c</sup> not available.

Source: ABS (Counts of Australian Businesses, Cat. no. 8165.0).

## 3.2 Market structure in retail

The regulation that most directly impacts on competition in Australian industry is the *Competition and Consumer Act 2010* (the Act). This Act contains provisions that prohibit contracts, arrangements and understandings that have the purpose or effect of substantially lessening competition, including mergers or acquisitions and conduct such as exclusive dealing and resale price maintenance. The Act is enforced by the competition regulator, the Australian Competition and Consumer Commission (ACCC).

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The ACCC uses several measures to assess the level of industry concentration, one of which is the proportion of output of the four largest firms or the CR<sub>4</sub> ratio. This measure can be useful in determining whether a particular market structure is likely to raise competition concerns, though it is indicative rather than determinative of the ability of a business to exert market power. Generally, on the basis of this ratio, a market would be considered concentrated for the purposes of a merger assessment if the CR<sub>4</sub> ratio was greater than 75 per cent (ACCC 2008d).

The retail industry can be characterised as very diverse and heterogeneous, both by sector and by geography. At the same time, the development of online retail is creating further diversity across the industry, and challenging the market positions of long-standing participants.

Given the diversity of the retail industry, it would be impossible in a study of this nature to carry out a comprehensive competition analysis covering all retail sectors and all regions. However, from a policy standpoint this is not a critical limitation because any competition policy issues that arise from an examination of this industry are not dependent on the outcome of any such sector-by-sector analysis, and should be acted upon in any case, as discussed for example in chapter 8 in relation to planning and zoning regulations.

### **Concentration levels across retail**

Concerns have been raised in Australia about the level of market concentration in various parts of the retail industry, and in particular that the market is dominated by only a few businesses. These concerns relate to the possible impact of concentration on market behaviour such as price-setting or purchasing. In this inquiry, some participants have suggested that concentration is increasing in certain sectors (Australian Toy Association, sub. 84) and regard increasing concentration as a matter of concern (Margetts, sub. 60). Beyond this inquiry, concern about market concentration in the grocery sector was central to the 2011 Senate inquiry on the impacts of supermarket price decisions on the dairy industry (SERC 2011).

In the food and liquor sector, the share of the market supplied by the largest three businesses is approximately 85 per cent, while in electrical this proportion is around 48 per cent (table 3.5). But for other segments listed, some of the firms may not be full competitors, and alternately some firms that are partial competitors may be grouped elsewhere where they compete more fully. Data such as these are of limited use in determining levels of market concentration.

**Table 3.5 Australian retail market share, major retailers, 2010-11**

<i>Sector</i>	<i>Major retailers</i>	<i>2010-11</i>
		%
<b>Food and liquor</b>	Woolworths	38
	Coles	27
	Metcash (including Franklins) <sup>a</sup>	20
<b>Department stores</b>	Big W	25
	Target	22
	Kmart	21
	Myer	19
	David Jones	12
<b>Clothing<sup>b</sup></b>	Just Group	6
	Specialty Fashion	5
	Country Road	3
	Oroton	2
	Kathmandu	1
<b>Electrical</b>	Harvey Norman <sup>c</sup>	23
	JB Hi-Fi	17
	Dick Smith Electronics	8
<b>Hardware</b>	Bunnings	19
	Reece	5
	Mitre 10	4
	Tradelink	3
	Danks	3

<sup>a</sup> Based on an estimated retail mark-up of 80% for Metcash and 50% for Danks and Mitre 10. <sup>b</sup> Citi data rounded to nearest per cent. <sup>c</sup> Harvey Norman only includes electrical and computer franchisees, which are Citi estimates.

Source: Citi (2011c).

Considering the grocery sector, table 3.6 compares the market shares of top grocery retailers for several countries including Australia for various years between 2005 and 2007. Australia's share held by the top two and top four retailers is higher than in some countries, though overall it is roughly in the middle of the range.

**Table 3.6 Grocery retailing market shares, between 2005 and 2007, by country**

Market share (%) <sup>a</sup>	Australia <sup>b</sup>	United Kingdom <sup>c</sup>	Canada <sup>d</sup>	New Zealand <sup>e</sup>	Ireland <sup>f</sup>	Netherlands <sup>g</sup>
Top 2	54	42	51	100	35-45	Around 45
3 <sup>rd</sup> & 4 <sup>th</sup>	19	24	25	neg.	15-25	Around 16
Top 4	73	65	76	100	50-70	Around 60

<sup>a</sup> Percentage values rounded up to nearest whole number. Data are for shares of grocery sales and supermarket sales, for various years between 2005 and 2007, so are only partially comparable. <sup>b</sup> 2006-07 data on grocery retail sales shares from ACCC public hearings transcript, Melbourne, 19 May 2008, and Woolworths, submission no. 233, as cited in ACCC 2008d. <sup>c</sup> 2007 data on retailers' shares of grocery sales from the UK Competition Commission, as cited in ACCC 2008d. <sup>d</sup> 2005 data on retailers' share of grocery sales from Elsevier Food International, as cited in ACCC 2008d. <sup>e</sup> 2007 share of national supermarket sales, *Woolworths Limited and Ors v The Commerce Commission*, HC WN CIV 2007-485-1255 [2007] NZHC 902 (12 September 2007), as cited in ACCC 2008d. <sup>f</sup> 2006 data on retailers' share of grocery sales from the Competition Authority (of Ireland), as cited in ACCC 2008d. <sup>g</sup> 2007 data on supermarkets' share of food, alcohol and tobacco sales from Netherlands Ministry of Agriculture 2010.

Source: ACCC (2008d); Netherlands Ministry of Agriculture (2010).

Measures of market concentration depend on the definition of market used, and the scope of the market under consideration. The Australian grocery sector illustrates this well, with wide variation in the estimated share of sales by Woolworths and Coles for different grocery product groups — from approximately 70 per cent for packaged groceries to 50-60 per cent for dairy and deli products, around 50 per cent for fresh meat, and up to 50 per cent for fruit and vegetables, bakery products and eggs (ACCC, 2008d).

Market concentration alone does not provide much guidance to the competitiveness of a market. What matters more are barriers to entry and, associated with these, the extent of market contestability. There are many examples in Australia of highly concentrated markets where barriers to entry are low, exposure to international trade is high and competition is intense. This distinction was made by the ACCC in its 2008 Grocery Inquiry, where it found that, while packaged groceries evidenced a high level of concentration, 'other factors including barriers to entry and expansion must be considered before any conclusions are drawn on the effectiveness of competition' (ACCC, 2008d, p. 51).

In response to the draft report of this inquiry, the National Association of Retail Grocers of Australia (NARGA) has expressed the concern that '... the dominance of the two major players [in the grocery market] ... makes it difficult for a new entrant to build the necessary critical mass needed to make distribution viable and match the incumbents' buying power.' (sub. DR191, p. 5). Notwithstanding this view, the grocery sector is facing significant competition from new entrants with different business models, primarily Aldi and most recently Costco, competition

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which the ACCC has found has an impact on the prices of the major supermarkets where they are located nearby (ACCC 2008d). For retail generally, the entry of new major international players in the grocery sector, such as Aldi and Costco, and also in the clothing sector, such as Zara and Gap, as well as a large number of other new entrants, indicate that barriers to entry are not substantial. Online competition (both local and offshore) is further reducing the impact of existing barriers to entry in bricks and mortar retail. The rise of online retailing is having a substantial impact in opening up the Australian retail market — competitors are not just down the street or in the next suburb, but are now national and international. This development is also occurring in sectors such as food, perishables and some bulky goods, but to a lesser extent as they are less exposed to online retailing.

At the same time, previous analysis, including that undertaken in the ACCC's Grocery Inquiry, and the profits and cost structures of some major retailers compared to overseas counterparts suggest there may still be some areas where barriers to entry are a potential concern from a competition standpoint.

Indeed, the ACCC 2008 Grocery Inquiry found a number of factors likely to be impacting on competition, including anti-competitive planning and zoning laws and objection processes and restrictive provisions in lease agreements for supermarket space that effectively prevented centre managers leasing space in centres to competing supermarkets.<sup>1</sup> In response to the ACCC's Grocery Inquiry, the Government referred the anti-competitive impacts of state and territory planning and zoning laws to COAG (Bowen 2008b) (see chapter 8).<sup>2</sup>

Following the Grocery Inquiry, in September 2009, the ACCC announced that it had accepted court enforceable undertakings from Coles Group Ltd and Woolworths Ltd to phase out all restrictive provisions in supermarket leases. In February 2010, the ACCC announced similar agreements with Aldi Foods, Franklins, SPAR Australia, Australian United Retailers (trading as Foodworks) and Metcash, and in May 2011, the ACCC announced that it had accepted an undertaking from Supabarn not to enter into new restrictive provisions in supermarket leases.

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<sup>1</sup> During the course of the Grocery Inquiry, the Australian Government had already moved to increase competition across the economy by changing foreign investment rules, allowing foreign investors up to 5 years rather than the previous 12 months in which to commence continuous substantial construction on any vacant land acquisitions (Bowen 2008a).

<sup>2</sup> In response to the Grocery Inquiry, the Government also proposed to consider with industry the ACCC's recommendations to enhance the operation of the Horticulture Code of Conduct. The Government also announced an intention to implement a 'creeping acquisition' law, and subsequently tabled draft legislative amendments in June 2010 (re-tabled in June 2011) (Bradbury 2011, pp. 8-9).

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In response to the Grocery Inquiry, the Government also introduced unit pricing through the Retail Grocery Industry (Unit Pricing) Code. The Code became enforceable from 1 December 2009 under the (then) *Trade Practices Act 1974*, and requires supermarkets and grocers to show prices by unit of measurement. The Code applies to store-based grocery retailers of specified size and scope and all online grocery retailers of specified scope (other grocery retailers can opt-in), and allows consumers to more easily compare prices. While the Queensland Consumers' Association (sub. DR222) has raised concerns about compliance with the Code, as well as its scope, a report commissioned by the ACCC found a high rate of compliance by supermarkets. However, it also found that compliance by small and independent supermarkets and online retailers was 'below expectations'. The ACCC worked with traders to address these concerns (ACCC, pers. comm., 26 October 2011).

Noting these developments in the grocery sector, for retail more broadly it is important that entry barriers relating to zoning and planning are acted upon – position is important for retail, and competition in some sectors is very geographically localised. Chapter 8 addresses planning and zoning regulations in more depth.

### **3.3 Indicators of retail performance**

#### **Profitability in the industry**

The retail industry makes a significant contribution to aggregate profits — almost \$19 billion or 7 per cent of all pre-tax profits generated by industry in 2009-10 (table 3.7). Almost half of this profit is attributed to *other store-based retailing*. For the retail industry as a whole, the average profit per business before tax was \$135 900, similar to that for all industries (\$132 300).

In 2009-10, profit in the retail industry increased 7.8 per cent from the preceding year. This was a better result than for all industries where profits grew by only 1.4 per cent (table 3.7). It is important to note that average profit does not reveal the dispersion of profit between businesses within the industry. The retail industry achieved broadly similar results to all industries on the percentage of businesses that made a profit, broke even and made a loss. Over 70 per cent of businesses in the retail industry made a profit, and 28 per cent made a loss. This pattern differed little between retail sectors.

**Table 3.7 Performance indicators, retail and all industries, 2009-10**

	<i>Food</i>	<i>Other store-based</i>	<i>Non-store and commission-based</i>	<i>Total retail<sup>a</sup></i>	<i>All industries</i>
Operating profit before tax (\$m) <sup>b</sup>	5 800	8 500	200	18 900	271 300
Average profit per business (\$) <sup>bc</sup>	221 600	95 800	25 100	135 900	132 300
Change in operating profit before tax (% , 2008-09 to 2009-10)	8.0	0.5	77.9	7.8	1.4
Profit margin (%) <sup>d</sup>	5.8	5.9	6.6	5.3	11.1
Industry value added per person employed (\$'000)	42.8	46.6	45.8	49.3	82.8
Businesses that made a profit (%)	73.0	70.1	65.4	70.3	73.1
Businesses that broke even (%)	0.1	1.6	3.4	1.3	1.4
Businesses that made a loss (%)	26.9	28.3	31.2	28.4	25.5

<sup>a</sup> Total retail includes motor vehicles and motor vehicle parts and fuel retailing. <sup>b</sup> Figures rounded to the nearest hundred. <sup>c</sup> Average profit per business is estimated as operating profit before tax divided by the number of businesses in each sector at the end of 2008-09. <sup>d</sup> Profit margin is the percentage of sales and service income available as operating profit before tax.

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

Compared with other industries, retail operates on low profit margins (measured by profit as a percentage of revenue). In 2009-10, the retail industry as a whole achieved a pre-tax profit margin of 5.3 per cent. The largest profit margin (6.6 per cent) was achieved in the *non-store and commission-based* retailing sector. This was significantly lower than the 11.1 per cent average for all industries. These differences however, reflect the business model of many retailers — relatively low margins on a high sales volume, but with comparatively low capital intensity. This can be seen by the comparatively high returns on capital in the sector (table 3.8).

Industry gross value added per person employed is also relatively low in the retail industry. In 2009-10, industry value added per person employed for the retail industry as a whole (\$49 300) was significantly lower than for all industries (\$82 800). This low value added per worker reflects the high labour intensity of the retail industry, typical of a service industry, and the comparatively low skill levels of the workforce. This will be further discussed in later chapters.

The retail industry performs relatively well in terms of its return on capital. Pre-tax return on capital has been relatively stable over the last two decades and more

significantly, the return on capital in the retail industry has been the same as the all industry average (24 per cent in 2010) and only marginally below the all industry average for the last five years (table 3.8). The return on capital in retail has been above that for many service industries such as accommodation and food services; arts and recreation services; electricity, gas, water and waste services; and transport, postal and warehousing.

**Table 3.8 Return on capital — gross operating surplus and gross mixed income as a percentage of net capital stock<sup>a</sup>**

	2006-2010	2010
	%	%
Agriculture, forestry and fishing	19	18
Mining	30	27
Manufacturing	26	26
Electricity, gas, water and waste services	6	6
Construction	107	102
Wholesale trade	25	27
<b>Retail trade</b>	<b>23</b>	<b>24</b>
Accommodation and food services	15	13
Transport, postal and warehousing	9	9
Information, media and telecommunications	21	21
Financial and insurance services	53	59
Rental, hiring and real estate services	10	9
Professional, scientific and technical services	37	52
Administrative and support services	14	12
Public administration and safety	6	6
Education and training	4	4
Health care and social assistance	12	12
Arts and recreation services	7	7
Other services	40	31
<b>All industries</b>	<b>25</b>	<b>24</b>

<sup>a</sup> Gross operating surplus is the income from production of incorporated enterprises while gross mixed income is the income from production of unincorporated enterprises. Gross Operating Surplus and gross mixed income include the excess of output over the costs incurred in producing that output before allowing for depreciation and interest payable. Capital stock is the value of the industry's assets.

Source: ABS (*Australian System of National Accounts*, Cat. no. 5204.0).

Profitability in the sector is related to firm size. For example, the Australian Taxation Office (ATO) found that in 2007-08, of all small retail enterprises with less than \$10 million in total income (from all sources, including sales of goods and services), 47.3 per cent made a loss. In comparison, larger retail enterprises fared

better — only 14.3 per cent of retail firms with total income between \$10 million and \$250 million made a loss (ATO 2010b).

There is some debate concerning the extent to which the largest retailers in Australia enjoy a higher profit margin than their overseas counterparts. Westfield comments that ‘none of the Australian retail firms could be claiming to make super profits’ (sub. 103, p. 24). Kierath and Wang (2011) provide the net profit margins of a selection of listed retail firms in different retail categories in Australia as having similar and sometimes lower net profit margins compared to their counterparts in the United States and United Kingdom/Europe (table 3.9).

**Table 3.9 Listed retailers’ profit margins<sup>a</sup>**

<i>Australia</i>		<i>United States</i>		<i>United Kingdom/Europe</i>	
<i>Company</i>	<i>Profit margin</i>	<i>Company</i>	<i>Profit margin</i>	<i>Company</i>	<i>Profit margin</i>
	%		%		%
David Jones	12.1	Best Buy	4.6	Debenhams	8.8
Myer	9.6	Netflix	11.5	Marks & Spencer	8.8
JB Hi-Fi	6.5	GAP	13.4	N Brown Group	14.1
HVN Franchisee	6.4	Limited Brands	15.2	ASOS	9.1
Big W	4.8	Coach	31.9	Inditex	15.6
Dick Smith	2.0	Guess	17.8	Dixons Retail	1.8
Bunnings	11.4	Lowe's	7.3	HMV	3.7
Office Works	5.3	Home Depot	8.5		
Target	10.0	Sak's	3.2		
Kmart	4.9	Macy's	7.6		
Premier	9.7	Nordstrom	12.0		
TRS	7.0	J.C. Penney	4.6		
Noni B	4.8	Kohl's	10.4		
Fantastic Furniture	6.1	Target	8.0		
Nick Scali	16.7	Amazon	4.3		
		Tiffany & Co.	19.5		
		Blue Nile	6.5		

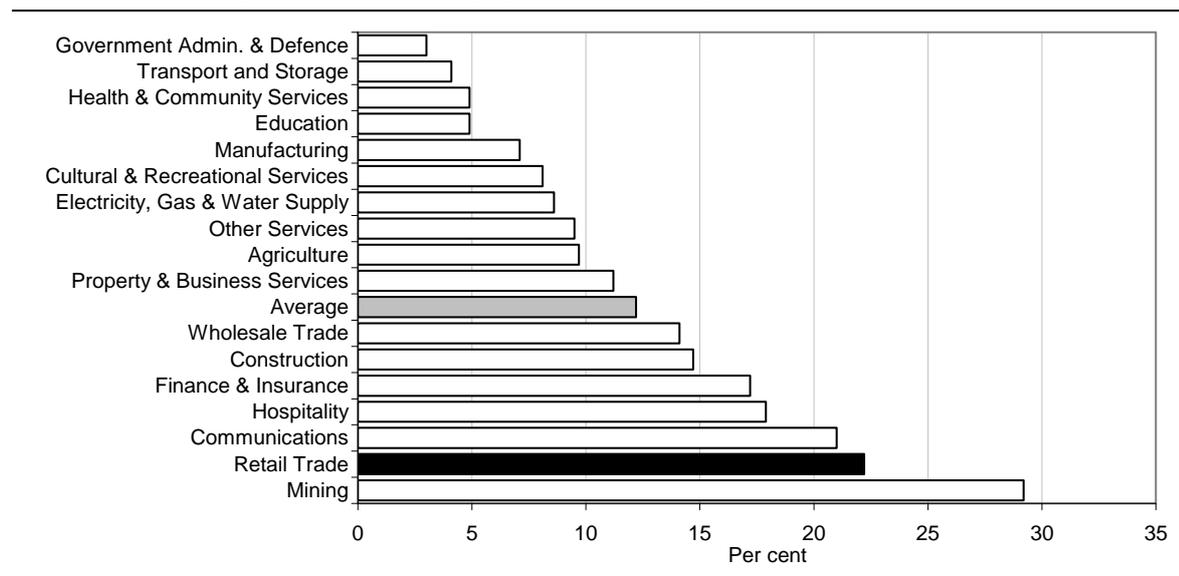
<sup>a</sup> Profit margins are EBIT (earnings before interest and taxes) over sales revenue. Companies report to different year ends, but data generally refer to the 2009-10 financial year.

Source: Kierath and Wang (2011).

But in relation to returns on shareholder funds, the retail industry compares favourably with other industries on several measures. A survey of the top 1350 businesses across all industries ranked retail trade companies second highest in returns on shareholder funds (after tax), over the five years to 2009-10 (figure 3.4).

Further, based on an international comparison by Citi Investment Research and Analysis (2011b), it would appear that many of Australia's larger retail firms also enjoy high returns on shareholder funds.

**Figure 3.4 Return on shareholder funds (after tax)**  
Top 1350 businesses (5 years to 2009-10)



Data source: Ruthven (IBISWorld) (2011).

Returns on shareholder funds have been found to be relatively strong in Australian retail, notwithstanding costs of labour and occupancy (including rental) that appear high when compared with those faced by comparable retailers in some other countries, such as the United States (Eslake 2011).

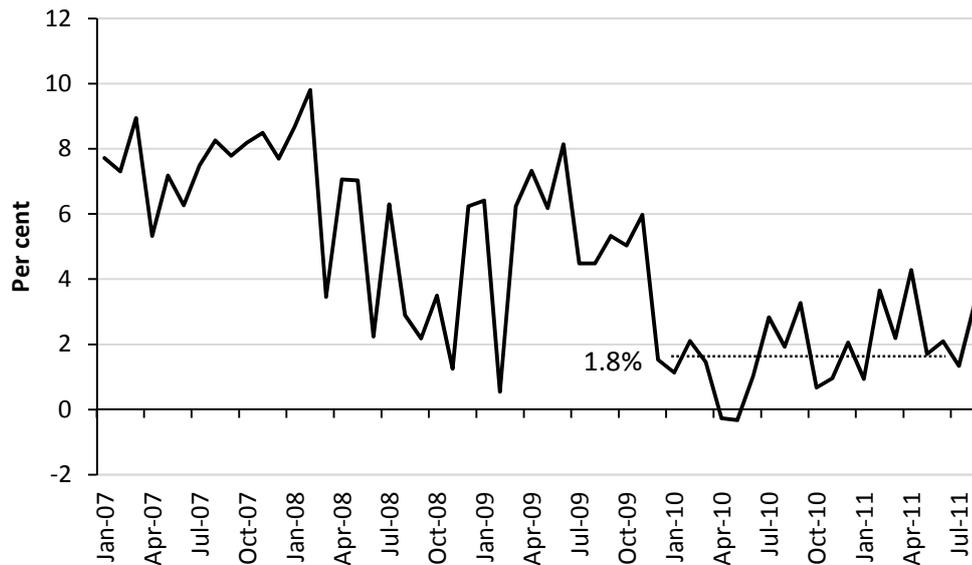
## Retail sales

The retail industry is currently experiencing poor sales compared to past years. This section addresses this issue and examines the extent to which the retail industry has been affected by the slower growth in spending in the economy, or has become disconnected from the rest of the economy and is suffering particular weakness. It also examines whether this is a recent phenomenon for the sector or a structural change associated with longer-term trends in the economy, a question which has important implications for the future of the sector.

While there is considerable month to month volatility in retail sales, a pattern has emerged pointing to retail trade sales being particularly weak over the past year. The growth in retail trade sales fell at the end of 2009 and nominal retail trade sales have averaged 1.8 per cent over the year through 2010 and the first and second

quarters of 2011 (figure 3.5). This is just over one fifth of the average of the nominal growth rate of the economy over the same period (7.6 per cent) (ABS 2011a).

**Figure 3.5 Change in retail sales<sup>a</sup>**  
Current prices



<sup>a</sup> Retail turnover does not include expenditure on cafés, restaurants and take away food services; data are month on previous year's month per cent change.

Data source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0).

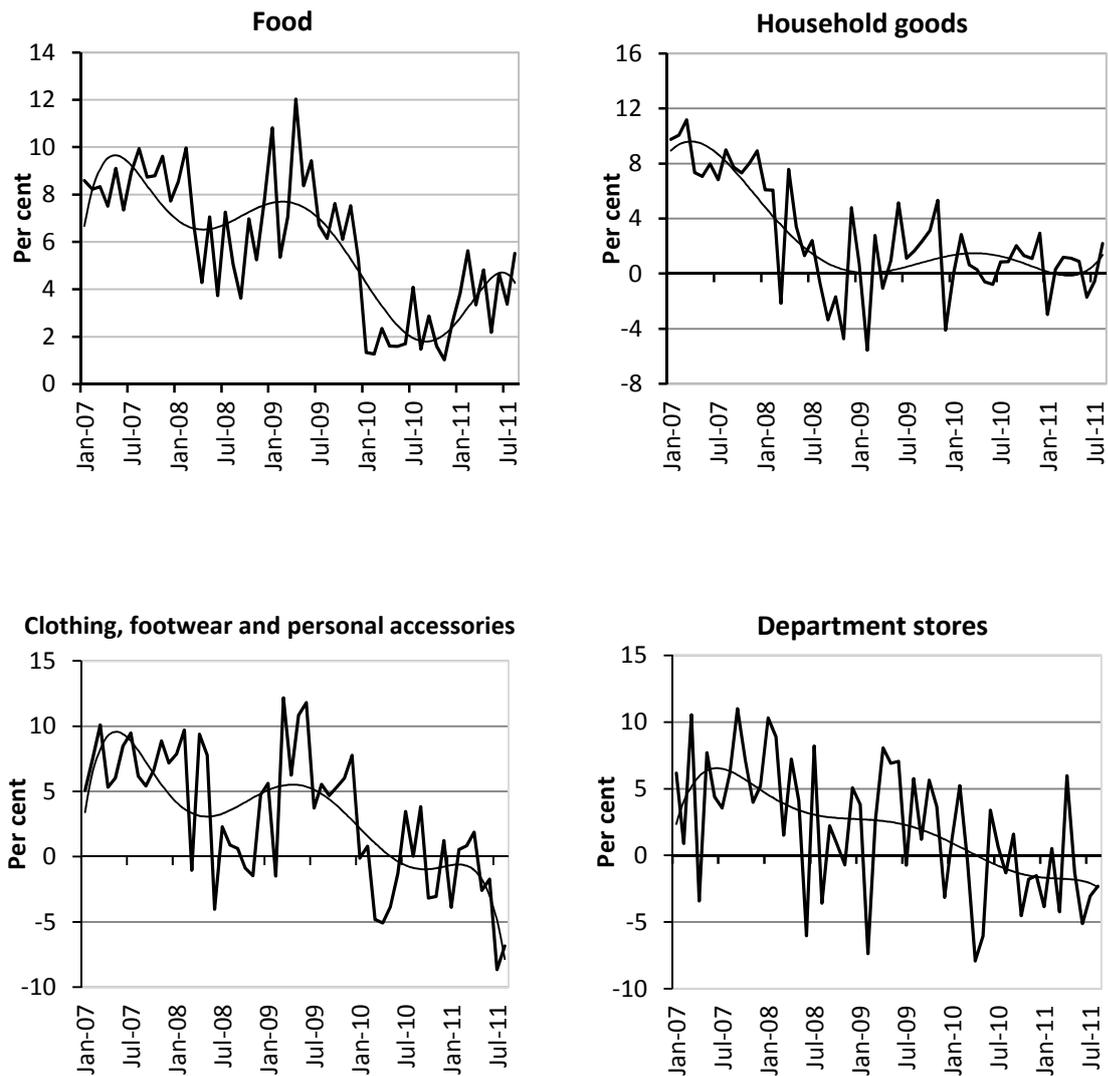
This pattern is broadly repeated across all of the sectors within the retail industry with sales growth in 2010 lower than that for 2009 and 2008 (figure 3.6). Indeed, for two categories — department stores and clothing, footwear and personal accessory retailing — growth was negative for much of 2010. While the growth rate of sales of food retailing — that is, supermarkets, grocery stores and convenience stores — was also lower, it remained positive during 2010. This is consistent with the Australian National Retailers Association's (ANRA) observation that sales in the retail industry have varied between non-discretionary (food and groceries) and discretionary goods (sub. 91).

The growth rate of retail sales of household goods — that is, electrical and electronic goods, hardware and garden supplies and furniture and houseware goods — fell dramatically from early 2007 growth rates and remained generally weak throughout the remaining period. For other retailing — that is, newspaper and book retailing, recreational goods, pharmaceuticals and non-store retailing — sales

dipped during the second half of 2008 but have since improved slightly, at least for the period for which the most recent data are available.

**Figure 3.6 Retail sales growth — component sectors, Jan 2007 to Aug 2011**

Current prices, per cent change over the year<sup>a</sup>

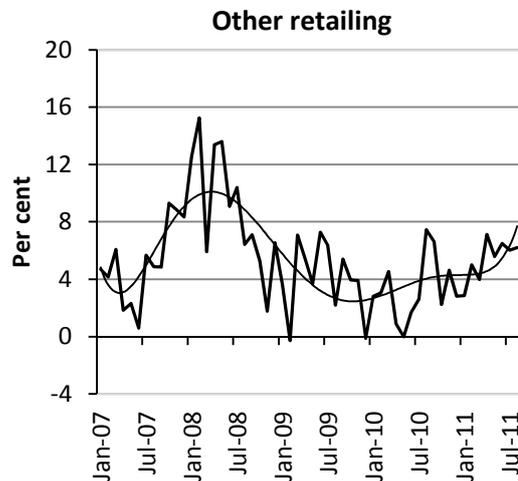


<sup>a</sup> Month on previous year's month per cent change.

Data source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0).

Figure 3.6 **Retail sales growth — component sectors, Jan 2007 to Aug 2011 (cont'd)**

Current prices, per cent change over the year<sup>a</sup>



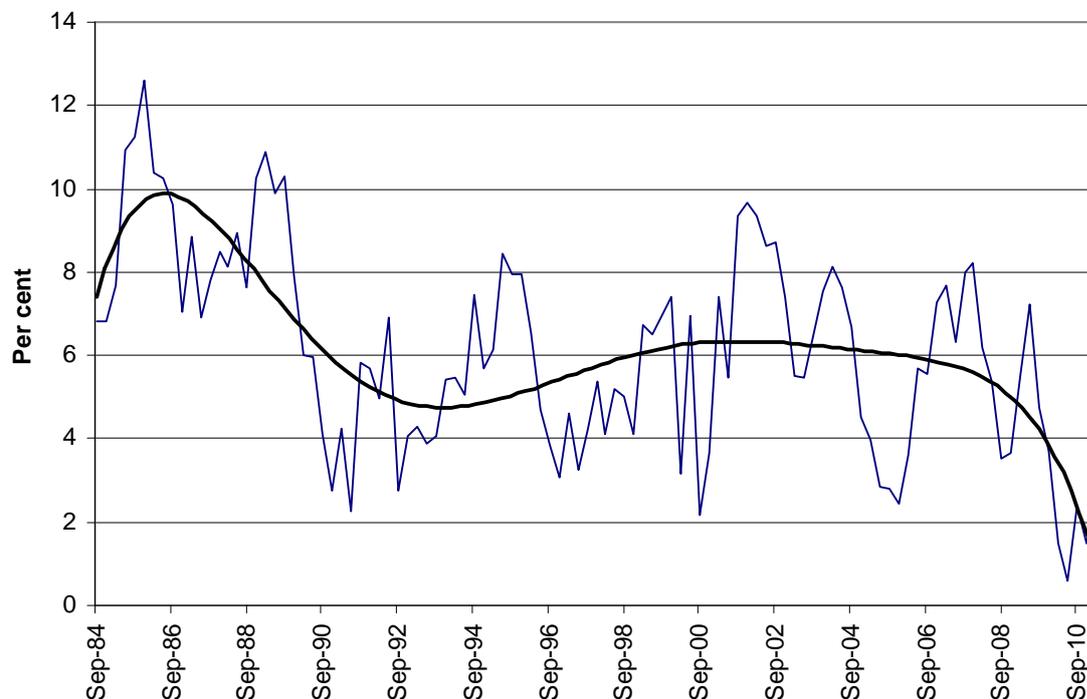
<sup>a</sup> Month on previous year's month per cent change.

Data source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0).

Reports by private analysts assess the opportunities for and threats to the retail sector, usually with a short- to mid-term focus. Such analyses include quantitative modelling or qualitative judgements which identify and analyse key factors affecting retail. These factors include levels of disposable income, interest rates and employment growth, as well as the adverse one-off effects on consumers' willingness to spend arising from factors such as weather conditions, the floods levy and overseas and local political developments. Many submissions have also commented on these factors impinging on the sales performance of the retail industry (ANRA, sub. 91; Myer Holdings Limited, sub. 88; Retail Traders' Association of Western Australia, sub. 80; Shop, Distributive & Allied Employees' Association, sub. 18).

While short-term factors have created a difficult trading environment for retailers, in order to gain some perspective on retail's recent poor sales experience, it is useful to view retail sales over an extended period and identify long-term trends. In considering the future contribution of the retail industry, it is of interest to note that while retail industry sales growth has moved through extended cycles of stronger or weaker growth, the *trend* of growth over the last two decades has been downwards (figure 3.7).

Figure 3.7 Change in retail turnover in current prices, 1984-2011<sup>a</sup>



<sup>a</sup> Over the year percentage change, from seasonally adjusted, quarterly data. Retail turnover does not include expenditure on cafés, restaurants and take away food services.

Data source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0).

### Has retail spending diverged from the wider economy?

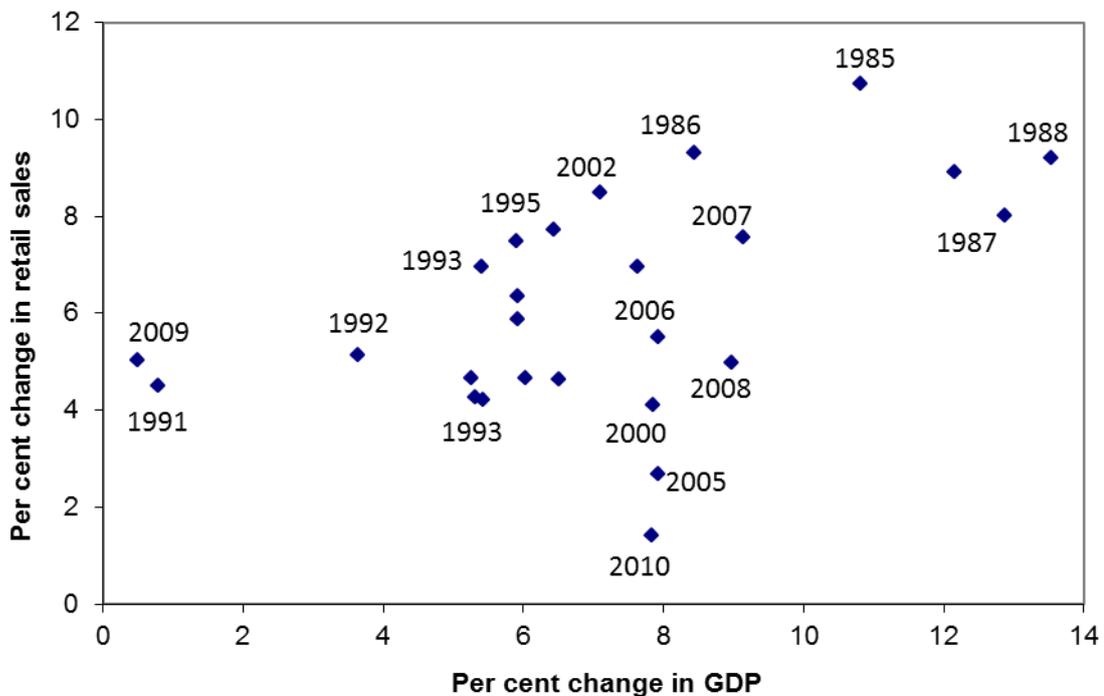
The submission from ANRA (sub. 91) argues that there is a two-speed economy with the retail industry languishing in a recovering broader economy. But the recent experience of poor retail sales growth in the context of much stronger economic growth is not without precedent. As can be seen from the scatter diagram below (figure 3.8) there is a positive but weak relationship between movement in GDP and in retail sales. However, the movement in retail sales was particularly weak during 2010, given the rise in nominal GDP.

Indeed, over the longer term, around only one-quarter of the variation in annual retail sales is explained by the variation in annual GDP.<sup>3</sup> This is unsurprising as various macroeconomic components can contribute and respond to GDP growth and

<sup>3</sup> The proportion of the variation in the dependent variable (y), retail sales, explained by the variation in the independent variable (x), GDP, is given by the  $R^2$  — a measure of the degree of correlation. In this case,  $R^2 = 0.2584$ , or a quarter of the variation in annual retail sales is explained by variation in annual GDP.

these components may have little direct relationship with retail sales. Apart from consumer expenditure, other sources of expenditure include government expenditure, business investment and exports. Indeed retail sales only represent around one third of household final consumption expenditure, the remainder being largely expenditure on services, such as utilities, accommodation and food services, education, health and finance. Retail sales, as will be shown below, can be influenced by consumers shifting their spending between retail goods and services, further undermining any strong relationship between movements in GDP and retail sales.

Figure 3.8 **Annual movement of nominal retail sales and nominal GDP, 1984 to 2010<sup>a</sup>**



<sup>a</sup> Current prices, yearly changes; retail turnover does not include expenditure on cafés, restaurants and take away food services.

Data source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0; *Australian National Accounts: National Income, Expenditure and Product*, Cat. no. 5206.0).

The recently identified weakness in retail trade sales relative to the broader economy is partly a reflection of the diversification of the economy over the past two decades — retail sales now make up a smaller proportion of economic activity. What is different in the recent performance of the retail industry is that the growth in retail spending has been particularly weak since mid-2009 compared to the

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spending in the broader economy. There are a number of possible explanations for this overall deterioration in the growth in retail trade — including that consumers are spending relatively less of their income and/or they are spending on areas outside of retail.

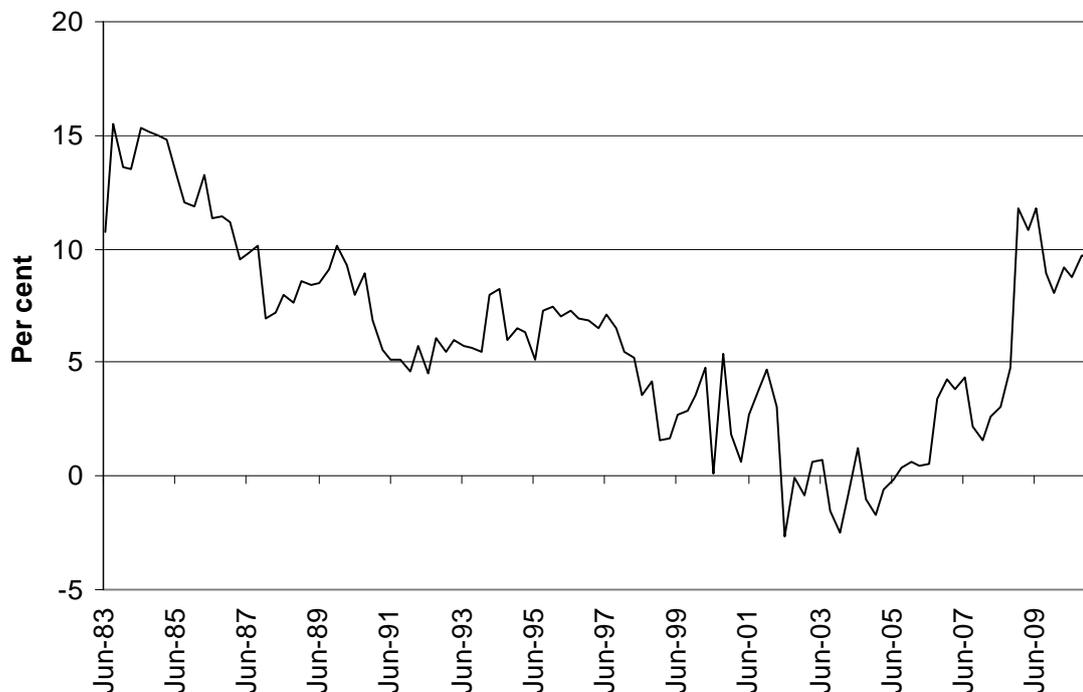
Turning first to the total spend by consumers, a central feature of the Australian macroeconomic landscape over the two decades to mid-2003 was the gradual fall in the household savings rate. The RBA (2011) has noted that the long-term fall in household savings occurred in an environment of financial deregulation and falls in nominal interest rates. The Commission (PC 2010a) found that the liberalisation of finance regulation and greater competition in the sector not only reduced costs, that is interest rate margins, but increased the number and type of financial products available to consumers. These changes led to a substantial rise in the household debt to income ratio which was associated with the stronger growth rates of household final consumption expenditure (HFCE) compared to household income over the past three decades.

As a consequence, most of the recent macroeconomic history of Australia has been characterised by a falling household savings rate (figure 3.9). This process appeared to run its course by the early 2000s when household savings were negative. There was a subsequent change in household behaviour towards greater savings as the recent rises in disposable household income have not been matched by equivalent increases in HFCE. Consequently, the savings rate is now around 9 to 10 per cent of household income. This shift appears to have commenced prior to the global financial crisis (GFC) in late 2008, but the GFC appears to have further unsettled households' reluctance to accept increased levels of debt and strengthened households' desire for greater savings.

This general change in attitudes towards savings is confirmed by data from Connolly and McGregor (2011) which shows not only a slowing of household borrowing, but an increase in the number of households paying down their home loans ahead of schedule and an increase in those paying off their credit cards in full each month. Consequently, the macroeconomy has recently been characterised by a relative unwillingness of households to increase their consumption to the extent that they have in the past, notwithstanding that household incomes have risen in recent years.

Figure 3.9 **Household savings ratio – net savings as a percentage of net disposable income, June 1983 to June 2009**

Current prices



Data source: ABS (Australian National Accounts: National Income, Expenditure and Product, Cat. no. 5206.0).

The retail industry has also been losing share of HFCE. HFCE includes payments on retailer supplied goods such as food, furnishings and household equipment, clothing and footwear and motor vehicles, but also payments on services supplied by other industry sectors such as health, education, finance, electricity, gas and fuel, travel, hospitality, accommodation and food services. As figure 3.10 shows, the retail share of HFCE has fallen from just over 35 per cent in the early 1980s to below 30 per cent currently.

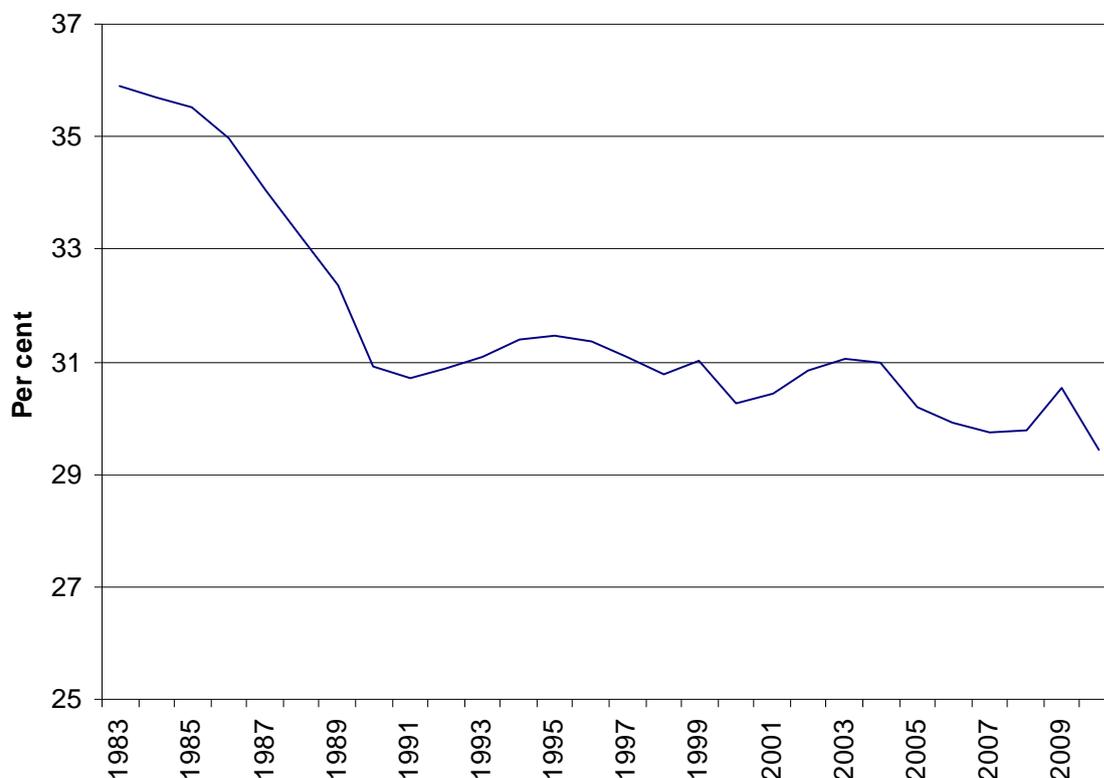
This decline was particularly marked during the 1980s due primarily to the increased importance of payments for finance and insurance services. The share has further declined since 2004 due to continued growth in the share of consumer payments on insurance and financial services as well as growth in the significance of payments on education services and rent. There was a short-run increase in the share of HFCE spent on retail trade in late 2008 up to mid-2009, likely associated with government cash bonuses in response to the GFC and the lowering of interest rates. Over the past year, the share of HFCE accounted for by retail trade has fallen below GFC levels.

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**Figure 3.10 Retail expenditure as a share of household final consumption expenditure, 1983-2009**

Current prices

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Data source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0; *Australian National Accounts: National Income, Expenditure and Product*, Cat. no. 5206.0).

Consequently, the retail industry has experienced sluggish demand over the past year relative to the rest of the economy because firstly, consumers are spending less, as demonstrated by the rising household savings ratio; and secondly, consumers are choosing to spend relatively less on goods sold by the retail industry, as demonstrated by the falling share of retail sales in HFCE. It is unclear to what extent these trends are likely to reverse or even moderate in the future.

A major reason why consumers are spending relatively less on retail supplied goods is because the prices of non-food goods has grown more slowly than the prices for services. The RBA (2009) has indicated that the aggregate price for manufactured goods over the last two decades has barely changed (0.1 per cent annual change) compared to food, beverages and tobacco (4.0 per cent annual change) and services (3.5 per cent annual change). That is, the prices of non-food goods supplied by retailers have declined relative to services consumed by households.

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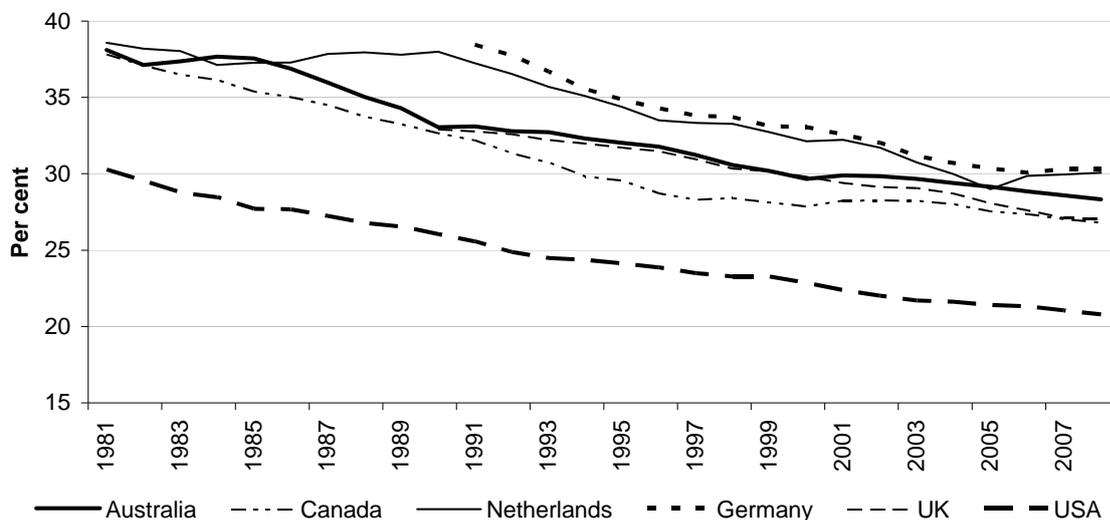
Most recently, in an effort to stimulate sales, retailers have engaged in substantial price discounting. This appears to have changed consumers' price expectations such that, according to some retailer organisations, consumers now expect goods to be constantly on sale and are unwilling to spend without these discounts (ANRA, sub. 91; Retail Traders' Association of Western Australia, sub. 80). This can be seen as accentuating the long-term fall in both the relative prices of goods sold by retailers and, as a consequence, the retail share of the consumer spend.

The differing rates of price movements between food and non-food retail have also affected the pattern of activity within the retail industry. The share of retail trade by nominal value accounted for by food and groceries has grown from 34 per cent in the early 1980s to 40 per cent currently, as food prices have not experienced the same deflationary price effects as other retail goods.

In this regard, the experience of Australian retailers is not too dissimilar from that of retailers in other countries. As figure 3.11 shows, the consumption of goods has fallen as a share of consumer expenditure in other comparable countries, albeit from quite different bases. This suggests that the experience of retailers relates to the nature of the goods they sell and that this sales performance is affected, unsurprisingly, by broader global shifts in consumer spending patterns and prices of their goods compared to those of services.

Baumol (1967) identified this trend and noted that productivity growth was greater in goods manufacturing compared to the provision of services, resulting in more downward pressure on goods prices. For Australia, the opening up of the economy through the elimination of quotas and reduction of tariffs in the late 1980s put further downward pressure on the prices of manufactured goods which have been passed on to consumers. The prices for services have grown more substantially reflecting the high share of wage cost in the delivery of services together with weaker productivity growth.

**Figure 3.11 Retail expenditure as a share of household final consumption expenditure, 1981-2007<sup>a</sup>**



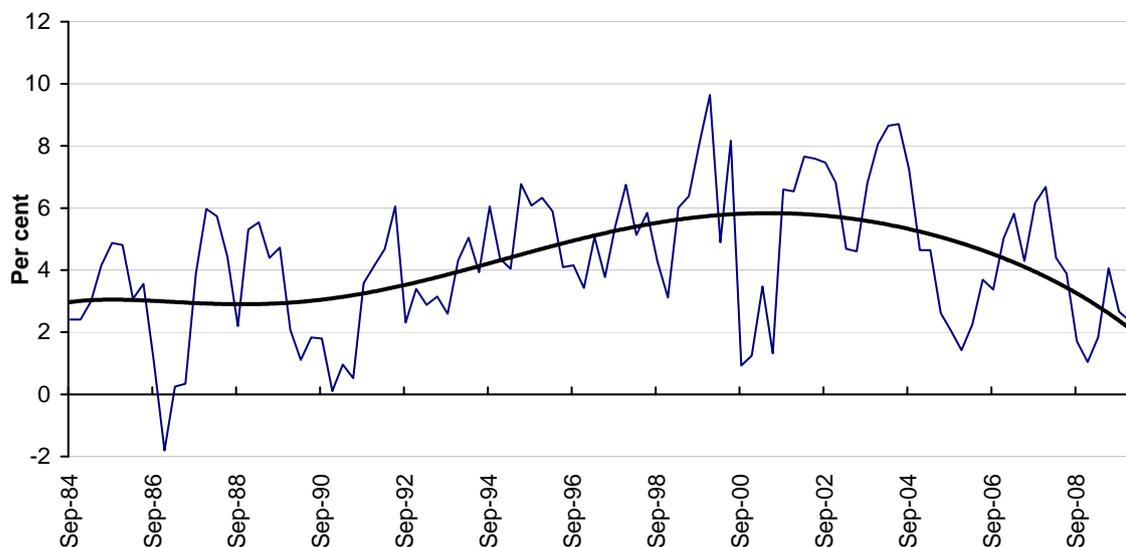
<sup>a</sup> Retail expenditure consists of spending on food, non-alcoholic beverages; alcoholic beverages and tobacco; clothing and footwear; furnishings, household equipment and routine maintenance of the house; audio-visual, photographic and information processing equipment; and newspapers, books and stationary.

Data source: OECD (StatExtracts, Table 5, accessed 6 May 2011).

Over the past decade, the large increase in the global supply of inexpensive manufactured products from China has reinforced the downward pressure on the price of manufactured goods (Francis 2007). The strong appreciation of the Australian dollar due to the strong growth in commodity prices has also placed downward pressure on the prices of imported goods.

Despite the recent difficult environment faced by retailers, Westfield notes that in its malls, the volume of sales have continued to grow albeit at a slower pace, as measured by average spend per visitor in exit surveys (sub. 103). While shoppers may have been paying lower prices for their purchases, they may also have been buying more. ABS data (figure 3.12) on the volume of retail sales confirm that this is a common experience across the retail industry.

Figure 3.12 Annual change in retail sales in volume terms, 1984-2010<sup>a</sup>



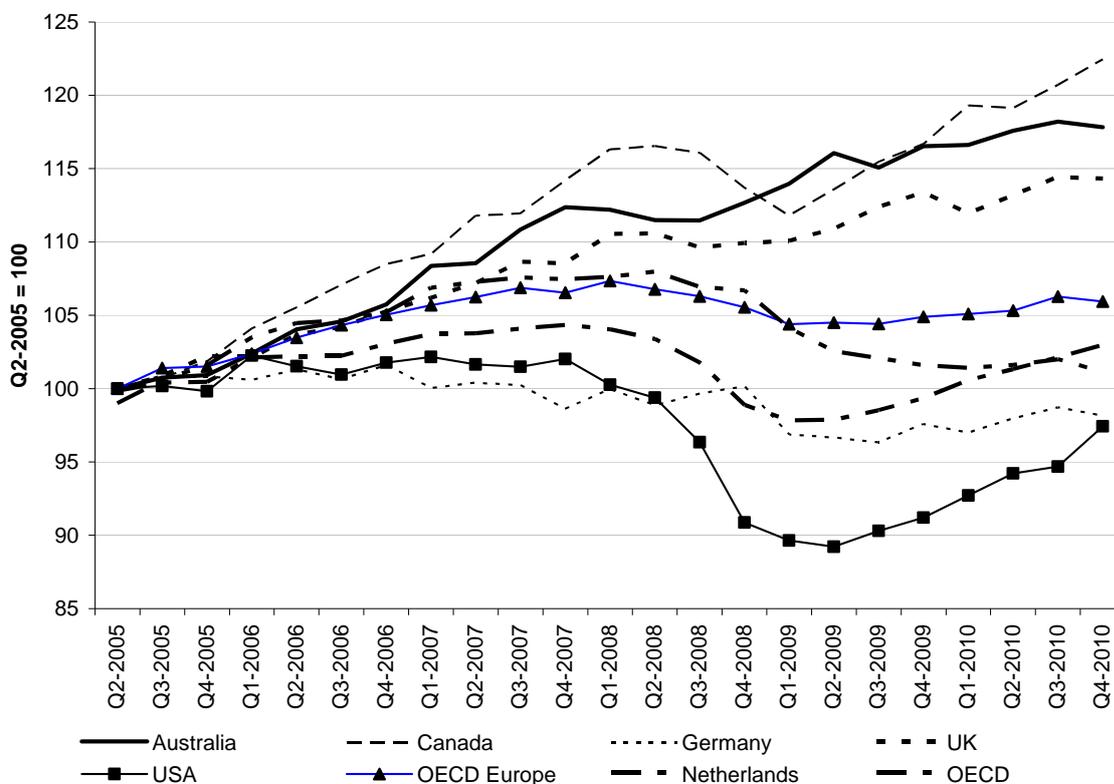
<sup>a</sup> Through the year percentage change seasonally adjusted constant price quarterly data. Retail turnover does not include expenditure on cafés, restaurants and take away food services.

Data source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0).

It should be noted, however, that while the growth rate of retail sales has declined in real terms over the past five years, it has remained positive overall. In most other OECD countries, growth in retail sales has been considerably slower and in some countries retail volumes have declined during this period and are currently only marginally above their 2005 levels (figure 3.13). As at the fourth quarter of 2010, retail sales in real terms in Australia were 17 per cent above their 2005 levels. In OECD countries in Europe, sales were only 5 per cent above 2005 levels, whereas in the United States, sales had still not regained their 2005 levels.

Part of this relatively weak growth in retail sales in volume terms has been due to the impact of the GFC. This appears to be particularly severe in the United States where retail sales fell by just over 10 per cent during 2009. But longer-term influences also appear to be operating across OECD countries, such as the shift in consumer demand towards services, dampening the growth of the sales of goods supplied by retailers.

Figure 3.13 Retail sales in volume terms, 2005-2010



Data source: OECD (OECDStat, extracted 9 May 2011).

It is possible to summarise and rank the relative significance of these longer-term factors affecting retail sales. The methodology for undertaking this is explained in box 3.1. The longer-term change in retail sales can be decomposed into factors such as retail share of expenditure, savings rates, growth in income and population growth. This allows judgments to be made about the relative significance of those factors that are uniquely important to retail and possibly those that can be affected by specific actions that can be taken by the retail industry and those broader influences largely outside the influence of the industry. Table 3.10 describes the results of this analysis.

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### Box 3.1 Decomposing the long-term influences on retail sales

Total retail sales in any period is the product of the share of the consumer dollar spent in the retail industry and the size of the consumer spend. The latter in turn is the product of the share of the disposable income that is spent, the level of per capita disposable income and the size of the population:

$$RS = (RS / HFC) \times (HFC / DI) \times (DI / POP) \times POP$$

Where,

$RS$  is the level of retail sales

$(RS / HFC)$  is the share of retail sales in household final consumption expenditure (HFC)

$(HFC / DI)$  is household final consumption as a share of disposable income (DI)

$(DI / POP)$  is the level of disposable income per capita

$POP$  is the size of the population

And  $\Delta$  represents percentage changes in the above variables

Change in the level of retail sales can be represented as:

$$\Delta RS = \Delta(RS / HFC) + \Delta(HFC / DI) + \Delta(DI / POP) + \Delta POP$$

As can be seen from table 3.10, annual growth in retail sales has broadly declined during the period from 9.6 per cent per year during the early 1980s to 4.8 per cent per year over the 5 years to 2010. This long-term fall in growth has been largely due to the fall in retail sales as a share of HFCE, that is, of what they do spend, consumers are spending relatively less on goods provided by retailers.

Growth of retail sales over the longer term has relied on the willingness of consumers to spend larger shares of their income, as well as increases in the disposable income of the population and population growth. Growth from such sources has counterbalanced the decreasing share of consumer spending directed towards the goods sold by retailers. The recent decline in the share of income that is consumed (-1.7 per cent), that is the increase in the savings ratio, has further exposed the influence of these broader macroeconomic factors.

**Table 3.10 Contributions to the change in retail sales<sup>a</sup>**

Current prices, annual growth rates

<i>Average annual change in:</i>	<i>Retail sales</i>	<i>Retail sales as a share of HFCE</i>	<i>HFCE as a share of disposable income</i>	<i>Disposable income per capita</i>	<i>Population</i>
	%	%	%	%	%
1982-1985	9.6	0.2	0.1	8.1	1.3
1985-1990	7.1	-2.9	1.0	7.5	1.5
1990-1995	5.7	0.8	0.1	3.7	1.2
1995-2000	4.7	-1.1	1.1	3.7	1.2
2000-2005	6.2	0.1	0.2	4.6	1.3
2005-2010	4.8	-0.5	-1.7	5.4	1.8

<sup>a</sup> Retail sales = Retail sales as a share of HFCE + HFCE as a share of disposable income + Disposable income per capita + Population. Figures may not add exactly due to rounding.

Source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0; *Australian National Accounts: National Income, Expenditure and Product*, Cat. no. 5206.0; *Australian Demographic Statistics*, Cat. no. 3101.0).

## Productivity

The productivity of the retail industry refers to how efficiently it performs its service function. Greater efficiencies achieved by the retail industry provide the potential for it to increase its contribution to the Australian economy by increasing profits of its shareholders and the wages of its workers, as well as to lower prices or provide better service to consumers. Increasingly, as more of the industry is exposed to international competition from overseas online retailers, the productivity of the sector is also important in understanding the competitive pressures and opportunities facing retailers.

Productivity refers to how efficiently an industry uses its inputs to produce goods and services — in its simplest measure it is the ratio of outputs produced to inputs used. Various measures of productivity can be developed, depending upon the nature of their intended use.

Retail businesses use measures of output and productivity that provide relevant information to inform decisions directed at maintaining their profitability and competitiveness. For example, sales data are readily available indicators of output. A sales revenue per square metre measure might help a supermarket to manage its floor space and layout or a shopping centre to provide traffic information for its tenants (Coles, sub. 79; Shopping Centre Council of Australia, sub. 106; Westfield, sub. 103). Other partial measures of productivity may include sales revenue per

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salesperson, which can be used to evaluate work flows, and inventory turnover which measures the amount of inventory relative to sales, that is, the efficiency of the use of capital tied up in stock employed in supporting sales.

However, these partial measures of productivity, while useful at the business level, do not convey how efficiently the retail industry uses capital, labour and other inputs from a broader economy-wide viewpoint. A definition of productivity which better accounts for the range of inputs and outputs is required if the retail industry's contribution to the economy is to be better understood.

*What is retail productivity and how is it measured?*

### *Measuring output and inputs*

The function of the retail industry and its contribution to the economy is one of intermediation between manufacturers/suppliers and consumers. Accordingly, the output produced by retail is not the goods that the industry obtains and re-sells to the final consumer, but the bundle of services it provides which can include the sourcing, displaying, advertising and selling of those goods, and providing customer advice and after-sales support. The range of functions of the retail industry is more fully discussed in chapter 2.

A way of measuring output in the retail industry is gross value added (GVA), which is the sales revenue, less the cost to the retailer of obtaining the goods sold (the wholesale price), less the intermediate costs, which refer to the day-to-day costs of running a retail business, such as electricity, rent and advertising. GVA is assumed to be proportional to the value of the tangible and intangible bundle of services that retailers provide to consumers — it measures the value that consumers are prepared to pay for the delivery of these retail functions.

Labour inputs are measured as hours worked. Capital inputs are measured as an index of capital services.

### *Labour productivity and multifactor productivity*

Labour productivity is a partial measure of productivity — that is, it is measured with respect to one type of input only. It is sometimes observed that labour productivity in the retail industry is low in comparison to other sectors of the economy. In 2009-10, the level of labour productivity (as measured by value added per hour worked) was \$28 compared to \$55 for the economy as a whole.

However, this low level of labour productivity is chiefly due to the nature of the industry — the retail industry provides services, and accordingly is relatively labour

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intensive — and does not necessarily indicate anything about the industry’s overall efficiency in the use of all inputs. Capital per full time equivalent worker in retail was \$62 000 compared to \$221 000 per full time equivalent worker in the economy as a whole. By way of comparison, in the closely connected wholesale sector, capital per full time equivalent worker was \$152 000 and value added per hour worked was \$65. The level of labour productivity in retail is broadly comparable to other service industries such as accommodation and food services with \$94 000 of capital per full time equivalent worker and with value added of \$24 per hour worked (ABS 2010a; ABS 2010i; ABS 2011f).

Growth in partial productivity measures, such as labour productivity, accounts for one input only and does not take into account the effects of any changes in the use of other inputs. As a prime example, growth in the use of capital (per unit of labour) is generally a major influence on labour productivity growth.

Growth in multifactor productivity (MFP), on the other hand, accounts for growth in both labour and capital inputs and therefore provides a more comprehensive measure of changes in efficiency. It reflects changes in things other than the amount of capital and labour used — such as improved management practices, adopting better work practices and improving stock flows and supply chains.

While productivity growth measures can provide good indications of improvements in the overall efficiency of an industry’s use of its inputs, this may not always align with improvements in consumer welfare. For example, if the extent of self-service grows in the retail industry, without any consequent drop in sales this would appear as an increase in multifactor productivity as the retailers’ labour inputs would not grow as fast as output. What it would actually represent is a shift from work undertaken by retail employees to customers. As another example, consumers may value shorter times spent in checkout queues which may be achieved through greater staffing levels. But this would be represented as a fall in productivity, unless consumers were prepared to pay more for this higher level of service.

### *Trends in Australian retail productivity growth*

Productivity growth fluctuates from year to year and in order to obtain an estimation of growth that is more representative of a long-term trend, rather than short-term volatility, average annual productivity growth rates are measured between peaks in productivity cycles, as identified by the ABS. Table 3.11 shows the annualised growth of labour productivity (LP) and multifactor productivity (MFP) of the retail industry and the 12-industry market sector,<sup>4</sup> for the last four productivity cycles,<sup>5</sup>

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<sup>4</sup> The 12-industry market sector includes: Agriculture, Forestry and Fishing; Mining; Manufacturing; Electricity, Gas, Water and Waste Services; Construction; Wholesale Trade;

and over the two decades to 2009-10. The productivity cycles are determined at the market sector level and not the retail industry level.

As explained above, growth in labour productivity is a single-factor productivity measure, a ‘catch-all’ measure of growth in output less growth in hours worked. Growth in labour productivity is the sum of the rate of capital deepening (or capital deepening largely driven by an increase in the ratio of capital to labour) and MFP (general efficiency improvement).

**Table 3.11 Retail and market sector productivity trends<sup>a</sup>**

Productivity cycle	<i>Retail<sup>b</sup></i>			<i>12-industry market sector</i>		
	<i>Annual growth:</i>			<i>Annual growth:</i>		
	<i>LP</i>	<i>Capital deepening</i>	<i>MFP</i>	<i>LP</i>	<i>Capital deepening</i>	<i>MFP</i>
	%	%	%	%	%	%
1988-89 to 1993-94	2.4	0.7	1.7	2.2	1.5	0.8
1993-94 to 1998-99	3.0	1.0	2.1	3.3	1.2	2.1
1998-99 to 2003-04	2.0	0.8	1.2	2.2	1.2	1.0
2003-04 to 2007-08 <sup>c</sup>	1.2	1.1	0.3	1.2	1.6	-0.3
<b>1985-86 to 2009-10</b>	<b>1.9</b>	<b>0.9</b>	<b>1.0</b>	<b>2.1</b>	<b>1.4</b>	<b>0.8</b>

<sup>a</sup> Labour productivity (LP) is the sum of capital deepening and MFP. Figures may not add due to rounding. <sup>b</sup> Includes motor vehicle and parts retailing and fuel retailing. <sup>c</sup> The last ABS productivity cycle does not appear to reflect the cycle in the retail industry, where there was a boost in MFP growth in 2009-10. From 2003-04 to 2009-10, MFP growth in retail was 1.0 per cent per annum. See footnote 5.

Source: ABS (*Experimental Estimates of Industry Multifactor Productivity, Australia: Detailed Productivity Estimates*, Cat. no. 5260.0.55.002), Productivity Commission estimates.

*Growth* in retail labour productivity has been significant over the last two decades, and is comparable to that of the 12-industry market sector (1.9 per cent per year in retail compared to 2.1 per cent in the 12-industry market sector). It has, however, declined in the last cycle, as it has also for the 12-industry market sector.

Retail Trade; Accommodation and Food Services; Transport, Postal and Warehousing; Information, Media and Telecommunications; Financial and Insurance Services; and Arts and Recreation Services.

<sup>5</sup> According to the information and analysis presented by Barnes (2011), market sector cycles provide a mostly reasonable basis to calculate underlying rates of productivity growth in retail trade. However, the last market-sector cycle in particular is an exception, with retail productivity going from above trend in 2003-04 to below trend in 2007-08. The period does not therefore represent a complete productivity cycle for the retail industry. More recent data suggest that, once the cycle for retail is complete, peak-to-peak productivity growth will be higher.

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The contribution of capital deepening to labour productivity was significant. Capital deepening has been occurring in the wider Australian economy, as well as in the retail industry, accounting for 0.9 percentage points of annualised labour productivity growth in retail over the past two decades (table 3.11). Capital deepening in the sector is discussed further in the next section.

MFP growth over the last two decades has contributed 1.0 percentage point to labour productivity growth in retail (table 3.11). A source of MFP growth was technological change in the form of scanning and computerisation which allowed reduced labour input and changed management systems; for example, scanning technology reduced the amount of time required to serve a customer (Johnston et al. 2000).

However, MFP has become less significant as a contributor to retail labour productivity growth since the late 1990s. The decrease in the growth of retail MFP has occurred in context of a broader productivity slump in the Australian economy in recent years. Indeed, in the last productivity cycle for the 12-industry market sector (2003-04 to 2007-08), MFP growth was actually negative.

The MFP performance of retail in that last cycle may be understated in table 3.11 (see footnote 5). The productivity cycle for retail diverges from the 2003-04 to 2007-08 cycle for the 12-industry market sector, and retail MFP was below trend in 2007-08. This means the reported MFP growth in retail of 0.3 per cent a year is likely an under-estimate of the MFP growth trend in retail. Thus MFP in retail may have actually been outperforming the rest of the Australian economy by a greater extent than previously suggested.

### *Capital deepening in retail*

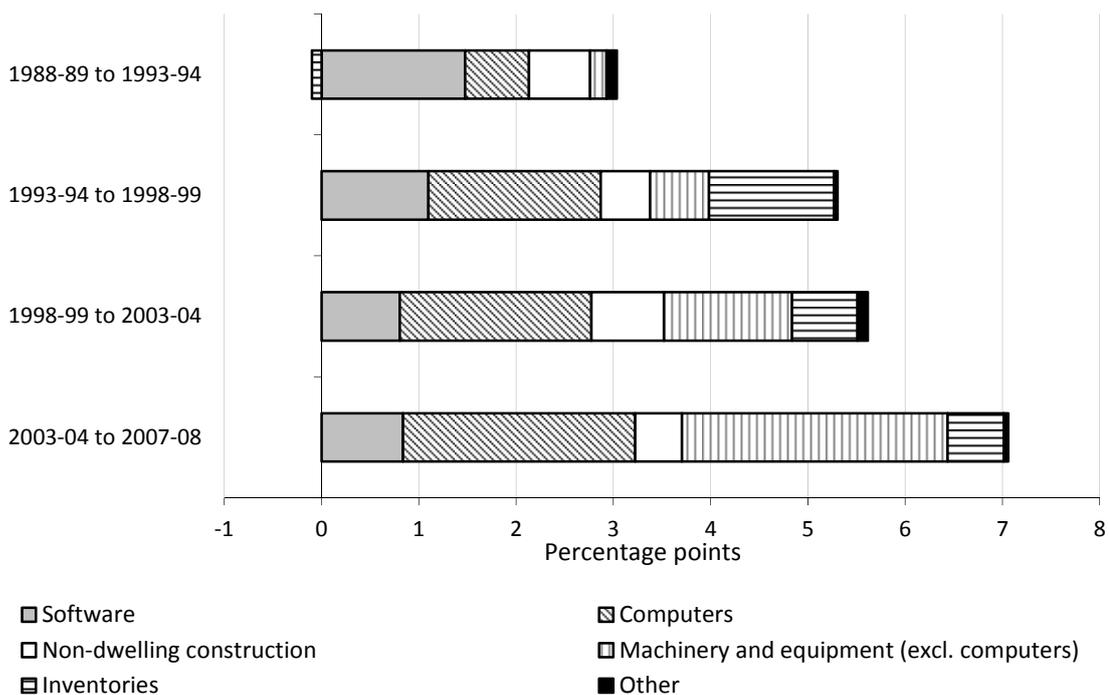
A Commission Staff Research Paper *Productivity in Australia's Wholesale and Retail Trade* (Johnston et al. 2000) found that the increase in the capital intensity of retail in the 1980s was due largely to the growth of market share of large firms at the expense of smaller firms which are typically more labour-intensive. Discussions with industry representatives at the time of the research suggests that strong competition was an important driver of increased productivity.

The industry experienced substantial rationalisation which allowed retailers to benefit from economies of scale with a trend away from small stores toward large speciality chains and the emergence of 'category killers' in big box retailing formats. In motor vehicle retailing, the number of dealerships fell substantially and in fuel retailing the number of service stations also fell significantly as these sectors consolidated.

Over the period 1985-86 to 2005-06, capital deepening in the retail industry was also driven by information and communications technology (ICT) (figure 3.14). This was due, in part, to the increased use of scanning technology, EFTPOS facilities and computerised inventory management systems (ABS 2007a). While barcode scanners in checkouts were available in the large retail chains by the end of the 1980s, it was throughout the 1990s that the technology was disseminated to smaller retailers. This technology has continued to develop with the roll-out of customer operated scanners during the 2000s.

Figure 3.14 breaks down the average annual growth rates of capital inputs across productivity cycles into different asset categories in order to identify the major drivers of capital deepening. It includes more recent data that were not available for the 2007 ABS study.

**Figure 3.14 Break-down of capital input growth in retail<sup>a</sup>**



<sup>a</sup> Includes motor vehicle and parts retailing and fuel retailing.

Data source: ABS (*Experimental Estimates of Industry Multifactor Productivity, Australia: Detailed Productivity Estimates*, Cat. no. 5260.0.55.002), Productivity Commission estimates.

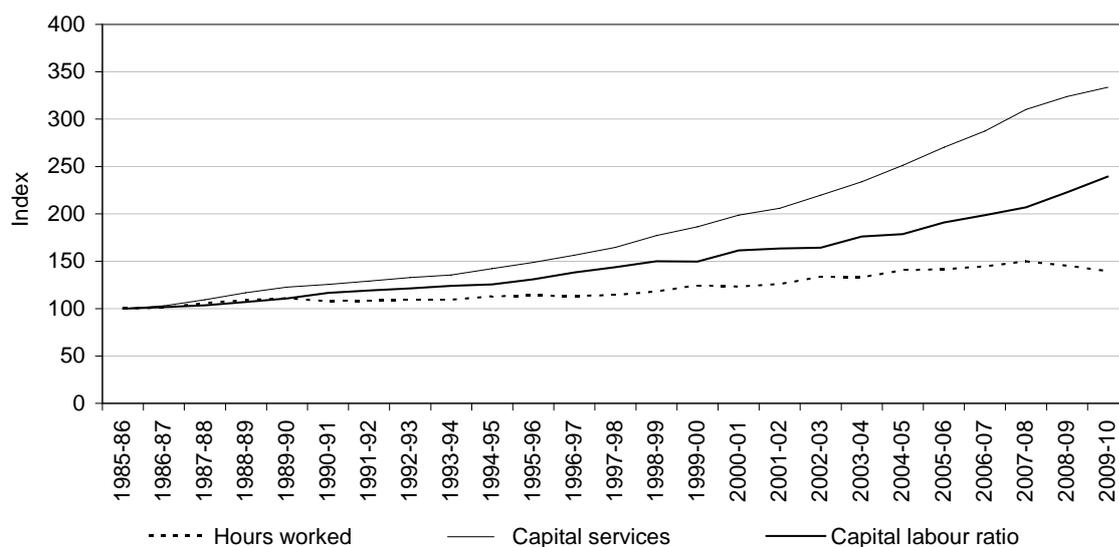
Over the last four productivity cycles, computers and computer software continued to make consistently significant contributions to capital input growth. Non-dwelling construction was also a significant contributor consistent with the shift towards larger stores. Electrical and electronic equipment, other plant and equipment and

road vehicles (which form part of machinery and equipment excluding computers) became more important contributors in the last two cycles.

In recent cycles the growth in inventory has been limited, suggesting that savings have been made in the capital tied up for this purpose. This is consistent with improvements in the management of stock flows partly through vertical integration of retail and wholesale activities and the adoption of just-in-time strategies whereby the costs of holding stock were shifted to suppliers. Scanning technologies allowed the tracking of goods through the distribution chain and provided a real time view of inventory levels allowing their economisation through ‘just-in-time’ stock management strategies.

The higher growth rate of capital inputs compared to labour inputs in retail has meant that the industry has become more capital intensive over time, and this can be seen in the growth in the capital-labour ratio (the capital inputs index over the hours worked index). Since the end of the last complete 12-industry market sector cycle, the growth of the capital-labour ratio has increased sharply; but as can be seen in figure 3.15, this was due not so much to the growth rate in capital inputs (which has recently slowed), but to a decline in the number of hours worked in the industry. As previously shown in figure 3.2, there has been a slight decline in the number of employees in retail since 2007-08.

**Figure 3.15 Retail capital-labour ratio<sup>a</sup>**  
Base year 1985-86



<sup>a</sup> Includes motor vehicle and parts retailing and fuel retailing.

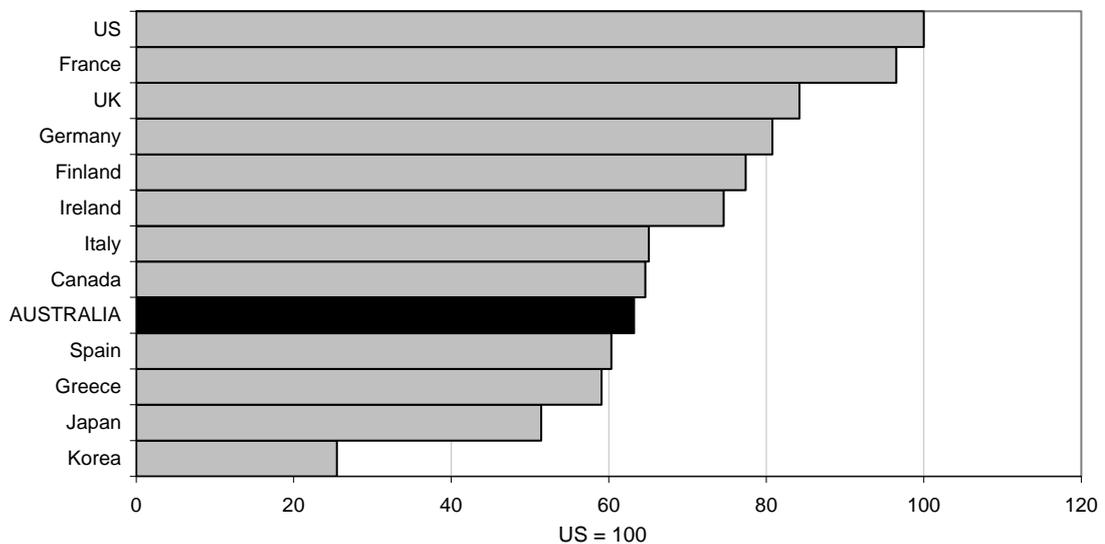
Data source: ABS (*Experimental Estimates of Industry Multifactor Productivity, Australia: Detailed Productivity Estimates*, Cat. no. 5260.0.55.002).

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### Australia's retail productivity by international comparison

In an international comparison of retail industry productivity at *levels* adjusted using industry-specific purchasing power parity (PPP) ratios, Timmer and Ypma (2006) found that in 2002, Australia ranked amongst the lowest when compared with other OECD countries. Such international comparisons provide a useful snapshot in terms of ranking different countries, but should not be taken as a precise indicator of the extent of differences among countries. Measures of output fail to capture differences in the quality of retail services across countries which vary due to differences in consumer taste and spending patterns, levels of competition and wage costs. For instance, the United States tends to have a much more service-focused retail industry said to be related to its lower wages (Timmer and Ypma 2006). International comparisons are often based on labour productivity. Yet the problems associated with using a single-factor productivity measure rather than multifactor productivity are further compounded because countries differ in their levels of capital deepening and in their mix of capital inputs.

**Figure 3.16 Retail labour productivity, 2007<sup>a</sup>**  
Gross value added/hour worked<sup>b</sup>



<sup>a</sup> Based on Division G-52 of the ISIC categories 'Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods'. <sup>b</sup> 2007 data were not available for all countries: for Canada, 2004 data are shown; for Ireland, 2005; for Korea 2005 and for Japan, 2006.

Data source: EU KLEMS (2009b); PWT 7.0 (2011).

Figure 3.16 compares the labour productivity (output over hours worked) of selected OECD countries against that of the United States, with output converted to

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US dollars at purchasing power parity.<sup>6</sup> It shows a significant gap between Australia and the United States, as well as other countries including France, Germany and the United Kingdom.

### *MFP trends in Australia and the United States*

MFP growth, rather than capital deepening, has been the main driver of labour productivity growth in retail in the United States and has allowed the United States to outperform other countries in retail productivity (McGuckin, Spiegelman, van Ark 2005; McKinsey 2001; Pilat 1997). The underlying trends which supported MFP growth in the United States include the rationalisation of wholesale and retail processes with barcode scanning technology, the replacement of low- with high-efficiency store formats, especially big-box retailers that can take advantage of greater economies-of-scale and the spread of innovation in management systems. The Australian experience in the 1990s productivity boom parallels that of the United States, where MFP rather than capital deepening was the prime driver of labour productivity growth. However, while the United States has maintained its MFP growth in retail beyond 2000, Australia has experienced a slump in MFP growth (figure 3.17).

Figure 3.17 compares the MFP indexes of Australia and the United States from the 2009 EU KLEMS dataset. Note that one of the major differences between this dataset and the ABS data used earlier in this report is that the effect of changes in ‘labour composition’ or skills mix, is included as an input, which otherwise would be included as contributing to MFP.

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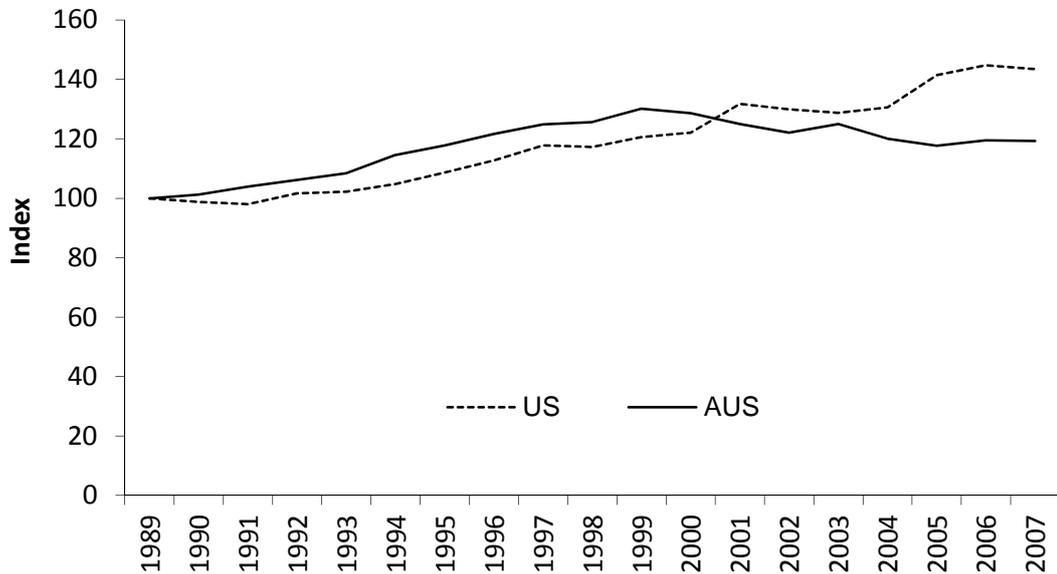
<sup>6</sup> The comparison shown in figure 3.16 differs from Timmer and Ypma’s work in that GDP-based PPPs have been used to deflate gross output. Timmer and Ypma use industry-based PPPs which are based on the relative prices within the retail industry, which are likely to be different to relative prices in the economy as a whole. Using Timmer and Ypma’s PPPs (base year 1997), the labour productivity gap between the US and Australia would appear to be far wider than using GDP-based PPPs. More updated industry-based PPPs are not available.

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Figure 3.17 **Retail MFP in Australia and the United States**

Base year 1989

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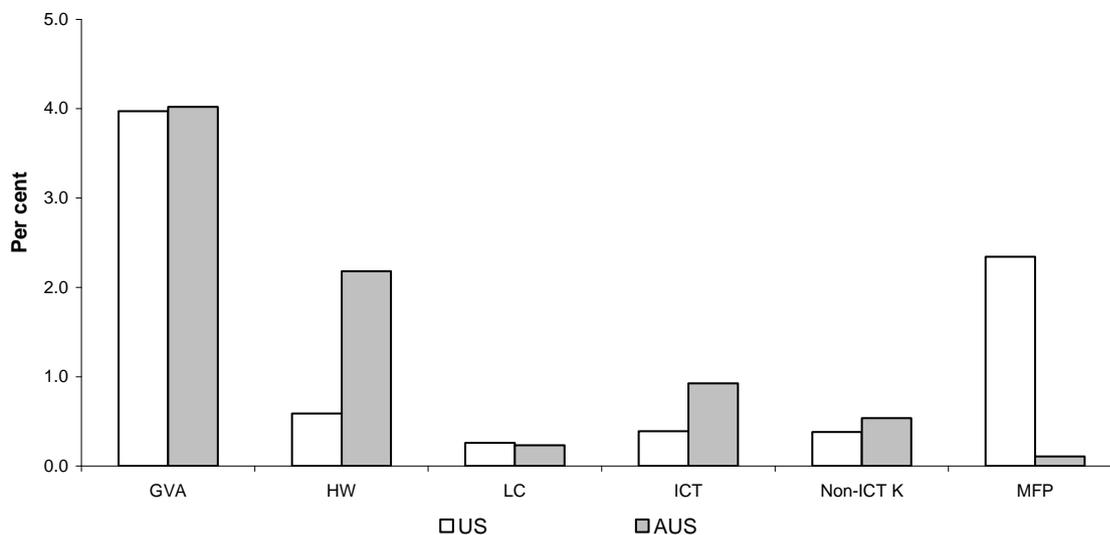


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Data source: EU KLEMS (2009b).

Figure 3.18 identifies the contributions of labour (hours worked), capital (disaggregated into information and communications technology and non-information communications technology), labour composition (skill levels) and multifactor productivity to the growth in retail output (GVA) in the United States and Australia. As can be seen, MFP growth in the United States was far more significant than in Australia. Output growth in Australia has been supported by much higher growth in labour and, to a lesser extent, capital. That is, these data suggest that compared with the United States, Australian retailing has added more labour and some ICT capital, rather than improved their efficiency, in order to drive output growth from the mid-1990s to 2007.

**Figure 3.18 US and Australian retail inputs and productivity growth, 1995-2007<sup>a</sup>**



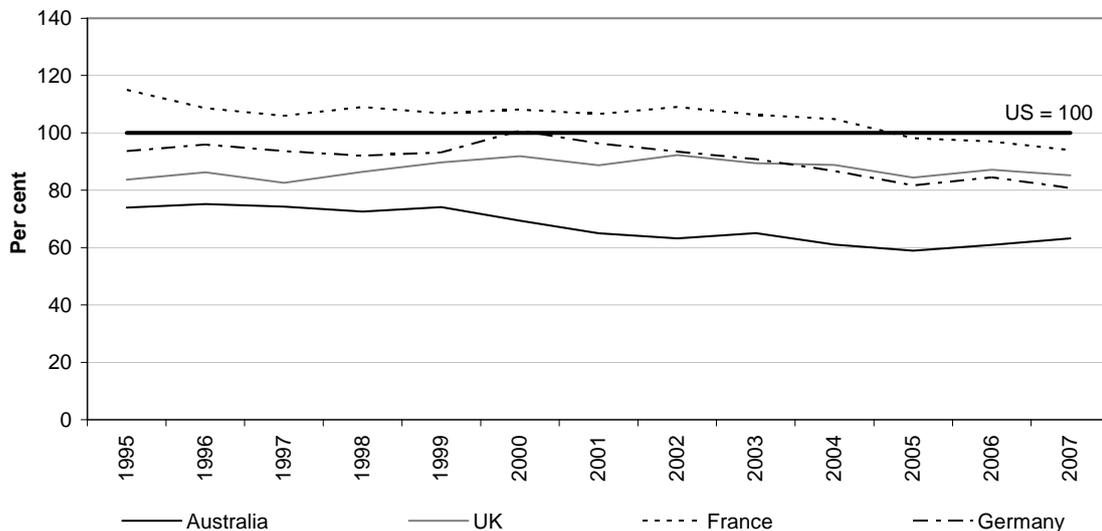
<sup>a</sup> GVA is gross value added; HW is labour input measured by hours worked; LC is labour composition, or the skills mix of the labour force; ICT is the information and communications technology component of capital inputs; Non-ICT K is the non-ICT component of capital inputs; MFP is multifactor productivity.

Data source: EU KLEMS (2009b).

There are different ways in which productivity comparisons can be made for the retail industry across different countries. These different methodologies produce variations in the size of the gap between Australian retail productivity levels and those in countries like the United States and parts of Europe. However, what is not questionable is that there is a large gap. Furthermore, it appears likely that the size of the gap between Australia and the United States has been increasing; nor has Australia made any significant gains in its position in regards to other leading countries (figure 3.19).

Woolworths (sub. 110) also identifies a gap between the United States and Australia in terms of output growth in retail, relative to the growth of the wider economy: retail industry growth relative to that of the wider economy was 15.5 per cent in the United States, compared with 6.3 per cent in Australia over the period 1995-2007. This indicates that prior to the GFC, the retail industry in Australia has performed relatively poorly in relation to the rest of the economy compared to the retail industry in the United States.

Figure 3.19 **Australian retail labour productivity in proportion to the United States, 1995-2007**



Data source: EU KLEMS (2009b), PWT 7.0 (2011).

The replacement of small, low-productivity retail stores with larger, higher-productivity stores that are better able to exploit economies of scale and scope has been identified as one of the main drivers of the retail productivity gains in the United States (Higon et al., 2010). In an empirical study of US retail, Foster, Haltiwanger and Krizan (2002) found that labour productivity growth in the sector was mostly explained by high-efficiency entrants displacing low-efficiency firms, rather than by existing firms becoming more efficient.

More intense competition plays an important role in facilitating the process by which retailers who are less innovative and responsive to changing consumer needs renew their business models or become displaced. Competition may stimulate the dissemination of innovative management strategies and efficient work processes, either through a retail firm with a successful business strategy being able to expand its market share, or through competitors being forced to adopt better practice. The success and dissemination of the Walmart model in the United States has been cited as making an important contribution to the US productivity boom (McKinsey 2001).

The spread and adoption of best-practice and innovation are influenced by the competitive environment firms operate in. As remarked by Fred Hilmer (2010), ‘just because firms and individuals *can* improve productivity does not mean that they *will* necessarily do so, particularly if there is no incentive for this to occur.’ (original emphasis). It is generally competition that provides the necessary incentive

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for productivity improvement. As Syverson (2011) notes in a standard, static model of firms' objective of profit maximisation, there would be no need for incentives since firms would undertake productivity-enhancing innovations to reduce their costs. But in a dynamic model, adopting these innovations would require firms to incur temporary disruption costs, or to risk failure. While heightened competition may not always provide sufficient conditions for innovation, where there is little or no competition, firms would have little incentive to incur the associated costs and risks.

It may not be realistic for Australia to close this productivity gap with the United States entirely. Australia does not have the same opportunities for economies of scale as the United States due to lower population density; furthermore, there may be differences in the composition or mix of retail in both countries. Nevertheless, this wide productivity gap will become increasingly pressing as Australian retail becomes more exposed to international competition.

### **3.4 Conclusion**

Retail sales in the short-term are affected by a wide range of factors which influence consumers' capacity and willingness to spend. These factors can be subject to considerable volatility making it difficult to forecast or explain the short term performance of the sector. However, over the longer term, more definitive judgements can be made.

The growth in retail sales has generally trended down over the past two decades due to long-term or structural changes in the economy and consumer behaviour which are lessening the significance of spending on retail goods in consumer budgets. Consumers are spending their rising incomes increasingly on services rather than goods. These include finance services, rent, education and accommodation and food services. The long-term downward trend in the growth of retail sales has been accentuated during the last half decade by the growing savings rate of consumers as they choose to pay down debt. In past periods the willingness of consumers to increase their spending at a rate faster than their disposable income counteracted the decline of retail spending as a share of household expenditure.

Notwithstanding the slowdown in the growth of retail sales, the sector's profitability has been around the average for industry as a whole. Indeed larger retailers' profitability appears better than the industry average with some retailers enjoying profits in excess of overseas retailers. However, the retail industry is diverse and there is not a consistent pattern of performance across the sector with a large

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number of retailers, many of them smaller retailers, making losses. But this pattern is not substantially different from many other industries.

While the retail industry is labour intensive and displays relatively low levels of labour productivity, it has experienced relatively strong rates of productivity growth over the past two decades, comparable to what was achieved in the broader Australian economy. However, a large part of this growth, particularly over the past decade, has been generated by increasing the capital intensity of the retail industry. This is associated with the growth of big box or large format retail establishments and investment in computerisation and machinery. Growth in multifactor productivity which arises from improvements in the management of capital and labour has been of less significance. The level of labour productivity in the retail industry remains below that for most other comparable countries in Europe and North America. The potential reasons underlying lower productivity in Australia will be discussed in later chapters.



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## 4 Trends and issues related to online retailing

### Key Points

- Online shopping in Australia is becoming more prominent.
  - Official ABS statistics are not produced for domestic and overseas online retail sales in Australia.
  - Market analysts estimate that the domestic online share of total retail sales in Australia is between 3 and 7 per cent. The Commission considers the share to be at the lower bound of these estimates at 4 per cent.
  - Overseas online sales account for around a third of total online sales. That is, around 2 per cent of total retail sales are being spent on overseas websites.
  - Domestic and overseas online sales account for 6 per cent of total retail spending in Australia in 2010 which equates to \$12.6 billion. By comparison, market analysts estimate the online share of retail sales in the United Kingdom and the United States at 11 per cent and 8 per cent respectively. Official estimates for the online share in the United Kingdom and United States are lower at 9 and 5 per cent respectively.
  - Online sales in Australia are projected to grow by between 10 and 15 per cent per annum over the next three years. New electronic devices including mobile phones with internet capability are stimulating further growth in online sales.
- Australian consumers are attracted to online shopping due to three main factors — lower prices, convenience and a wider range of goods to choose from compared to those available from bricks and mortar retailers.
- Online penetration of retail sales in Australia is much higher in categories such as books, CDs, DVDs, clothing, sporting goods, electrical and electronic goods, cosmetics, and toys, but much lower for groceries.
- Food retailing is the sector least likely to be exposed to overseas online competition. Just over one half of the retail industry in Australia could be regarded as trade exposed, but to a varying extent, depending upon the nature of goods being sold. Smaller and non-perishable items are more likely to be purchased online from overseas.
- Australian online consumers and retailers appear to be adequately served in terms of current product delivery services, albeit perhaps not as efficiently as some other countries. But logistics service providers will need to continue to invest and improve to cater to projected strong growth in online retail sales forecast in the future.

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One of the major developments in retail shopping in Australia over the past decade has been the emergence and growth of online retail shopping. This chapter looks at what is driving this growth, the significance of online retailing across market segments, the advantages online shopping offers to consumers and the opportunities and challenges it provides to retailers. The chapter also examines whether current logistics such as broadband penetration and speeds and product delivery services are adequate to cater for growth in online shopping.

## **4.1 The development of e-commerce and online retailing**

Terms such as e-commerce or internet commerce have been developed to describe the process in which electronic transactions facilitate the exchange of, and payment for, goods and services between businesses, consumers, government and other public and private organisations using the internet, computer networks and portable electronic devices. The OECD definition of e-commerce further specifies that it relates to the ordering of goods and services over the internet, but the payment and ultimate delivery of the good or service can be conducted on or offline (ACMA 2010a).

Online retailing is a subset of e-commerce and refers to the purchase and sale of goods between consumers and retailers using the internet — also referred to as the business to consumer (or B2C) market. Other terms are interchanged for online retailing including e-tailing. Online retailing establishments can take the form of ‘pure plays’ in which businesses provide online only services in particular retail categories or as part of multi-channel establishments where online activities are combined with bricks and mortar operations.

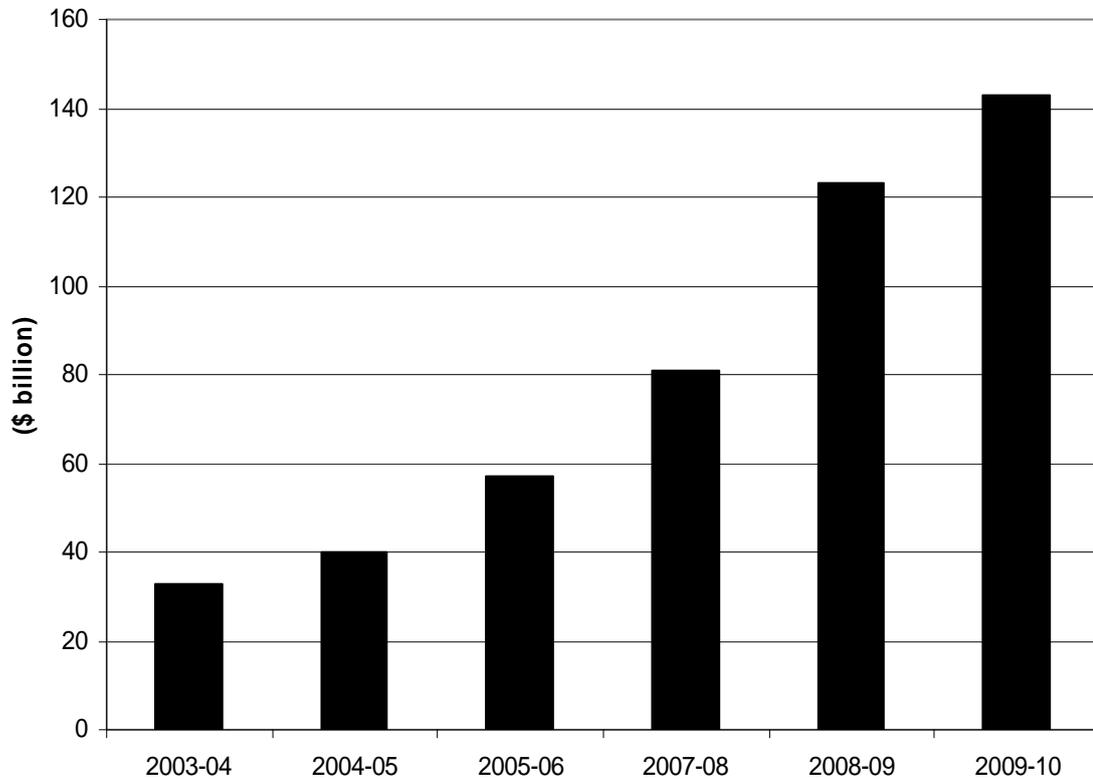
ABS data show that the value of internet commerce in Australia has grown strongly in the past five years, having more than tripled from \$40 billion in 2004-05 to \$143 billion in 2009-10 (figure 4.1). While the data relates to purchases of goods and services across the economy, and not specifically purchases for retail goods, it is indicative of the increasing importance of internet e-commerce to the Australian economy.

The internet has had an important transformative impact on the way in which businesses interact with other businesses (or B2B) as well as consumers by facilitating the rapid transfer of information, reducing transactions costs associated with locating and purchasing supplies, and enabling more efficient production and delivery of goods and services.

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Figure 4.1 Value of internet commerce in Australia, 2003-04 to 2009-10<sup>a</sup>

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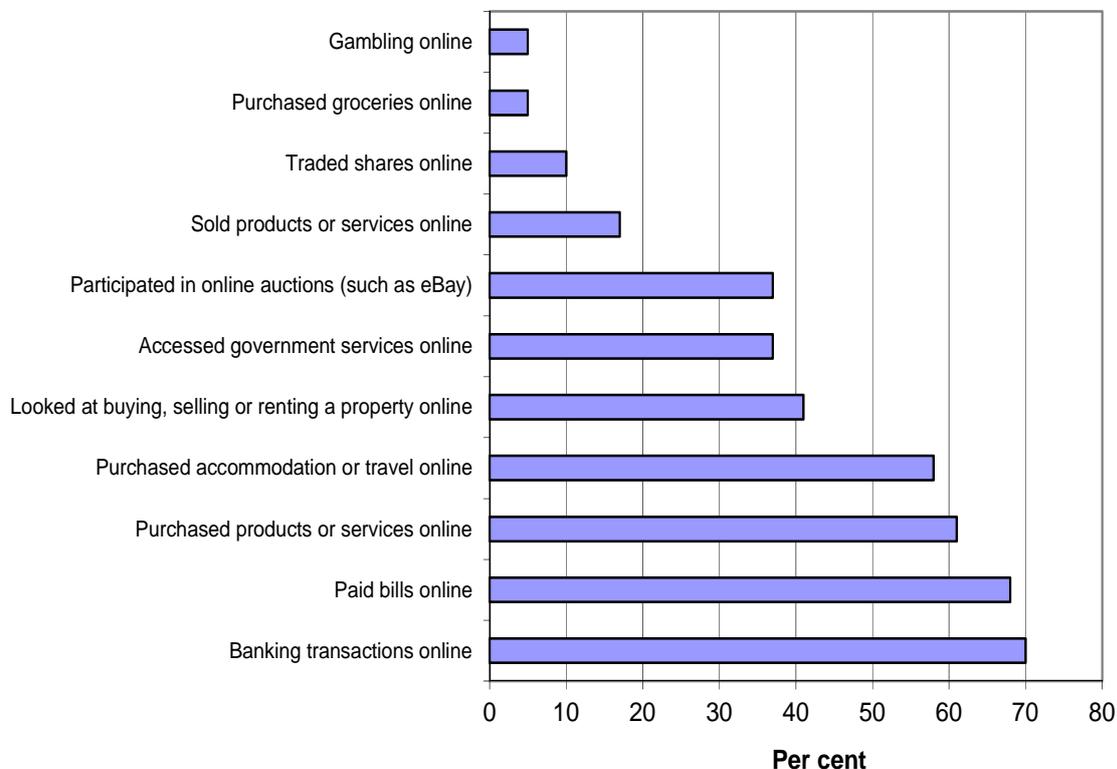


<sup>a</sup> Refers to purchases of goods and services online regardless of how payment is made and includes both Business to Consumer transactions (B2C) and Business to Business transactions (B2B). Data were not provided by the ABS for 2006-07.

Source: ABS (*Summary of IT Use and Innovation in Australian Business, 2009-10*, Cat. no. 8166.0).

The growth of online shopping has occurred in the context of greater familiarity with, and confidence in, the use of the internet across a range of activities. This reflects a substantial cultural change in how the community is conducting economic transactions. The results of a survey conducted by the Australian Communications and Media Authority (ACMA) in 2010 noted that 88 per cent of respondents had performed one or more e-commerce activity in the previous six months and 61 per cent had purchased goods online (ACMA 2010a) (figure 4.2).

**Figure 4.2 Use of internet for e-commerce activities in previous six months by household internet users, 2010**



Source: ACMA (2010a).

### Business use of e-commerce

ABS data provide information on the use of the internet by retail establishments to place and receive orders. While this information relates to both B2C and B2B activities, it demonstrates the growth in the proportion of businesses that use the internet to expand their sales to both businesses and consumers and improve the efficiency of ordering inputs.

Businesses in retail have been more active in using the internet to conduct trade. In 2009-10, just over a third (33.8 per cent) of businesses in retail received orders (from both consumers and other businesses) via the internet which compares with just less than a quarter (24.8 per cent) of all businesses. The extent of growth in the use of the internet by retailers to undertake business activities is underlined by the finding that just under a fifth (18.9 per cent) of retail establishments received orders via the internet in 2005-06. But retail lags behind industries such as wholesale trade

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(48.8 per cent in 2009-10) and manufacturing (40.8 per cent) in terms of receiving orders (ABS 2011h).

Sensis survey results show a much higher proportion of retail businesses using the internet to conduct business than ABS data. The survey shows an increasing proportion of retail SMEs (small and medium enterprises) use the internet to facilitate online sales and provide information on products and services than they did five years earlier. Three quarters of retail SMEs placed orders for goods and services using the internet in 2010, just under three quarters (73 per cent) took orders over the internet, and 68 per cent received payments. By comparison 46 per cent of retail SMEs placed orders over the internet in 2005, 36 per cent took orders and 51 per cent received payment over the internet (Sensis 2005; 2010).

Research conducted by Deloitte Access Economics (2011) confirms that retailers have become much more active in taking advantage of the internet to place and take orders, but they are not as perceptive as businesses in other industries of the potential benefits from internet transaction activity. For example, retail lags a number of industries in terms of the perception of benefits to general business and management from internet use. For example, only 28 per cent of retailers perceived benefits from internet commerce which compared with one half of employers in primary, finance and real estate industries.

## **Household trends in internet access and broadband speed**

The increasing use by the community of the internet for e-commerce is facilitated by growing household access to the internet and improvements in the technical capability of internet infrastructure.

A much higher proportion of households in Australia have internet access now compared with a decade ago. ABS data show that between 1998 and 2008-09, the share of households with access to the internet increased substantially from 16 per cent to 72 per cent (figure 4.3) (ABS 2010h). It is expected that the household internet penetration rate will continue to rise to around 83 per cent by 2015 (Forrester 2011). The proportion of households in Australia with broadband<sup>1</sup> access has risen more sharply — from 16 per cent in 2004-05 to 62 per cent in 2008-09 (figure 4.3) (ABS 2010h).

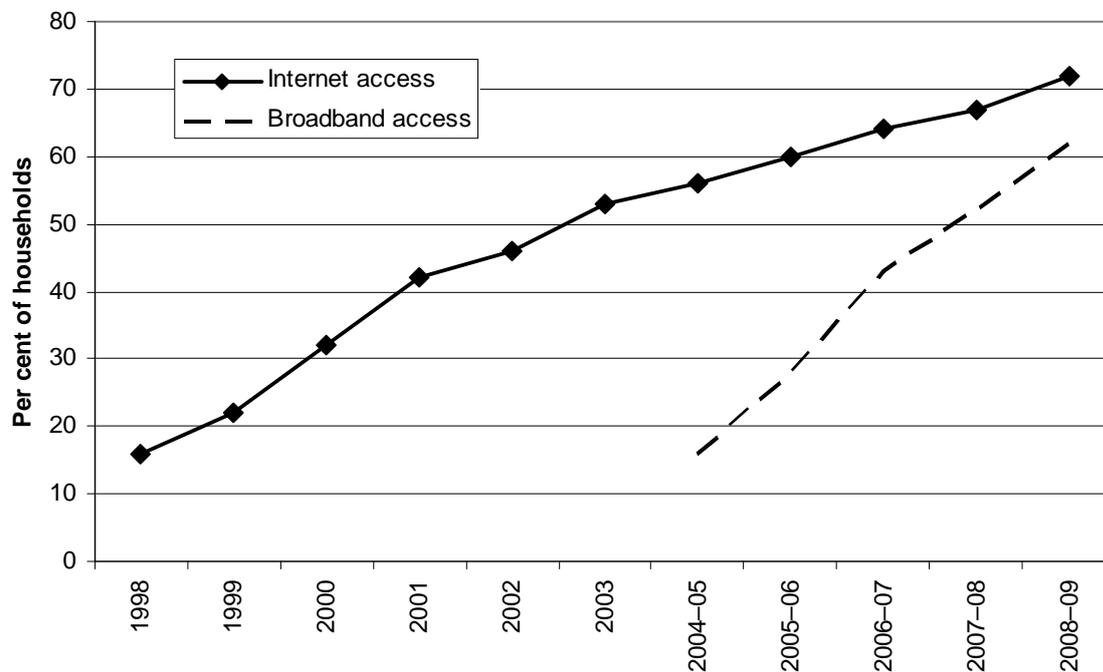
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<sup>1</sup> Broadband is defined by the ABS as an 'always on' Internet connection with an access speed equal to or greater than 256 Kilobits per second (Kbps).

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**Figure 4.3 Proportion of households in Australia with internet and broadband access, 1998 to 2008-09**

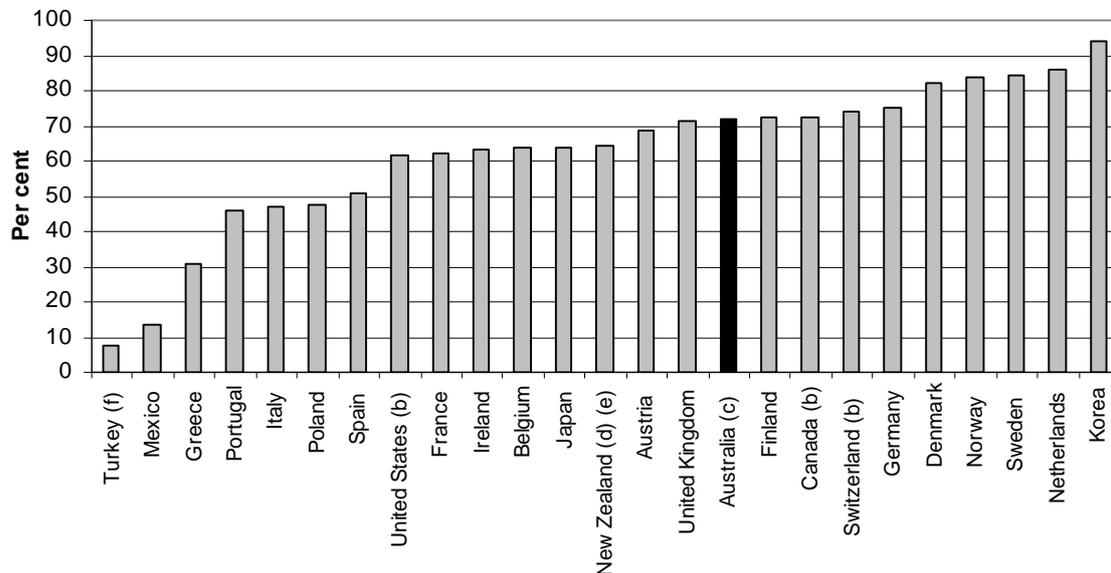
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Source: ABS (*Household Use of Information Technology, Australia*, Cat. no. 8146.0, 2008-2009).

ABS data show that Australia is ranked 12<sup>th</sup> out of 27 selected countries in terms of household internet penetration. Australia's household internet penetration rate is slightly higher than the rate recorded in the United Kingdom and the United States, but much lower than the rate recorded in countries such as Korea, the Netherlands, Sweden and Norway (figure 4.4).

Figure 4.4 Household access to the internet – selected OECD countries, 2008<sup>a</sup>

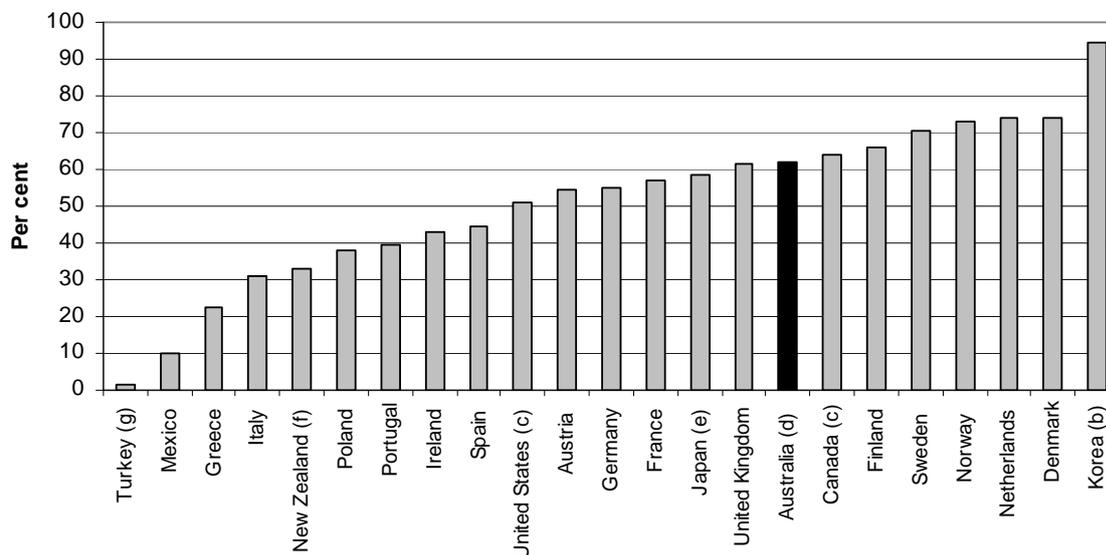


<sup>a</sup> 2008 unless otherwise indicated; internet access via any device; data for EU countries plus Norway and Turkey relates to the first quarter of the reference year. <sup>b</sup> Relates to 2007. <sup>c</sup> Relates to July 2008 to June 2009. <sup>d</sup> Relates to 2006. <sup>e</sup> Visitor-only dwellings such as hotels are excluded. <sup>f</sup> Relates to 2005.

Source: ABS (*Household Use of Information Technology, Australia*, Cat. no. 8146.0, 2008-2009).

At 62 per cent, Australia is ranked 9<sup>th</sup> out of 27 selected countries in terms of household broadband penetration (figure 4.5). Australia is ranked higher than countries such as Japan, the United States and New Zealand, but is ranked much lower than Korea, Denmark and many other Nordic countries. More recent estimates from Macquarie Equities Research (2011a) indicate that the broadband internet penetration rate in Australia may have increased since the last survey was undertaken by the ABS, to around 64.4 per cent in March 2011.

**Figure 4.5 Household access to broadband – selected OECD countries, 2008<sup>a</sup>**



<sup>a</sup> 2008 unless otherwise indicated. <sup>b</sup> Data also includes mobile phone access. <sup>c</sup> Relates to 2007. <sup>d</sup> Relates to July 2008 to June 2009. <sup>e</sup> Only broadband internet access via a computer. <sup>f</sup> Relates to 2006. <sup>g</sup> Relates to 2005.

Source: ABS (*Household Use of Information Technology, Australia*, Cat. no. 8146.0, 2008-2009).

## Business use of broadband

According to the results of the Sensis e-business survey of SMEs, broadband has almost blanket coverage of SMEs in Australia — 99 per cent of medium sized enterprises and 96 per cent of smaller enterprises. The benefits of broadband access cited by SMEs included speed of access, increased internet efficiency, greater access to applications, freeing up of phone lines for other purposes and reduced costs (Sensis 2010).

ABS data show similar results for SMEs. ABS data also show that 99.6 per cent of firms employing 200 people or more (or large sized firms) had broadband as their internet connection (ABS 2009a).

## Adequacy of broadband access and speed

Submissions and reports by market analysts highlight that slower broadband speeds may be inhibiting growth in online retail sales. Slow internet connection speeds may act as an impediment to online shopping, though the magnitude of their impact is a

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matter of some conjecture. It has been claimed by market analysts that technological deficiencies such as slow connection speeds may be limiting functionality for households and may be limiting the sale of some products online such as digital downloads of movies (Macquarie Equities Research 2011a). Evidence other than this is limited.

eBay note:

... wider access to higher speed internet is crucial to data-rich browsing, including online shopping. This is especially so in light of reports that 23 per cent of US consumers who were dissatisfied and 18 per cent of those who abandoned e-commerce transactions did so due to slow websites (Forrester Consulting 2009), indicating consumer demand is stifled by insufficient technologies. (sub. 101, p. 24)

Benefits of faster broadband connections are not just restricted to business to consumer transactions. In a survey conducted by the Australian Industry Group (AiG) of over 500 CEOs in 2008, businesses identified the ability to download large data files more quickly as the most important benefit of a faster broadband network. A greater capacity to transact online was the second highest benefit reported (AiG and Deloitte 2008).

The AiG survey also found that small firms are more likely to lack the skilled staff and technological capabilities needed to take advantage of the commercial opportunities resulting from a fast broadband network in the future (AiG and Deloitte 2008). Other potential impediments to online retailing are discussed later in the chapter while skill shortages in retail are discussed in more detail in chapter 12.

OECD data show that Australia ranked 10<sup>th</sup> out of 34 countries in September 2010 in terms of average *advertised* broadband speeds offered by providers. Average advertised broadband speeds in Australia are below countries such as Sweden, Japan, France and Korea, but exceed the averages in the United Kingdom and the United States. In terms of median advertised broadband speeds, Australia is ranked 6<sup>th</sup> (OECD 2011).

However, data from Akamai<sup>2</sup> (2011) show Australia ranked much lower at 33<sup>rd</sup> out of 49 countries in terms of *observed* average connection speeds — at 3.4 Mbps (megabits per second) in the first quarter of 2011. Around 57 per cent of customers in Australia had connection speed of 2 Mbs or above which is well below the share in the majority of European countries, Hong Kong, Korea and Canada of around 90 per cent.

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<sup>2</sup> Akamai delivers between 20 and 30 per cent of total worldwide internet content through its global server network.

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While noting some limitations in connection speeds which act as an impediment to online purchasing and selling, it would appear that by international standards Australia is fairly well placed in terms of broadband penetration. As discussed earlier, the rate of broadband penetration in Australia is comparable with many OECD countries, including the United States and the United Kingdom. Further, survey results indicate that broadband has almost blanket coverage of SMEs who had internet access. From this information it would appear that broadband access and speeds are not major factors limiting current demand for online purchasing services.

## **4.2 Online share of retail sales**

In the absence of official estimates for online sales, the following section examines market analyst estimates for the domestic and overseas share of total retail sales.

### **Domestic online retail share of total retail sales**

A number of estimates have been provided by private market analysts for domestic online retail sales as a share of total retail sales. These estimates range from 3 to 7 per cent. These differences are significant and imply that the level of domestic online expenditure could have been as low as \$6.3 billion or as high as \$14.8 billion in 2010. Significant differences exist between market analysts as to where they sourced their data and the assumptions they make in determining their estimates for domestic online share of total retail sales activity (box 4.1) <sup>3</sup>

The Reserve Bank of Australia (RBA) collects monthly data from financial institutions on the value of spending on debit and credit cards which is further split into spending with domestic and overseas merchants. From this data source, estimates can be made of the domestic internet purchase share (where the payment card is not physically present) of all domestic electronic purchases (using credit and debit cards). This share has grown from around 7 per cent in 2005 to 10 per cent in 2010 (RBA 2011). It should be noted that this analysis is not simply related to retail trade electronic transactions, but includes all e-commerce purchase activity which would include travel and entertainment purchases. Because of this wider coverage of e-commerce activity, the RBA figure should not be construed as a proxy for the online retail share of all retail sales.

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<sup>3</sup> Most market analysts use ABS estimates for total retail sales or turnover which do not include sales of fuel and motor vehicles and parts. This approach has also been adopted by the Commission in this report.

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**Box 4.1 Market analyst estimates for domestic online share of total retail sales**

The following estimates have been provided by market analysts for the domestic online share of total retail sales in 2010:

- Citi Investment and Research, Access Economics and Frost and Sullivan — 3 per cent
  - IBISWorld — 3.7 per cent
  - Bell Potter/Southern Cross Equities — 4 per cent
  - Forrester Research — 7 per cent
- Not all data sources from private analysts are transparent. Some cite data from financial intermediaries such as PayPal or data from other market analysts as evidence for the extent of online sales and ABS data for the size of total retail sales. Other analysts simply cite their own methodology or estimates with no references to data sources which makes it difficult to make comparisons with other estimates.
  - Citi Investment and Research base their estimates for the size of retail spend on various ABS surveys and their estimates for online purchases from information on visits to websites, conversion from visits to actual sales and average value of basket size when purchases are made.
  - There is also inconsistency between estimation methodologies in terms of which retail categories are included or excluded from estimates of domestic online spend. For example, Southern Cross Equities removes online sales of groceries and travel and entertainment from the estimate of online spend; Citi Investment and Research includes groceries, alcohol and food; Forrester excludes cafes, restaurants and take away food, travel, and peer-to-peer auctions; while Macquarie takes out travel, entertainment ticketing and financial services.

**The extent of overseas online retail sales**

There is a large disparity between market analyst estimates for the proportion of online transactions by Australian consumers conducted on overseas websites. These estimates range between 20 and 50 per cent (box 4.2). These differences are important, as they indicate the extent to which domestic retailers have embraced online selling, the extent of the leakage of sales overseas, and the possible ramifications for retail output and employment.

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#### **Box 4.2 Market estimates for online spend overseas**

- Forrester estimated that around 20 per cent of total Australian online expenditure will be with overseas web sites through to 2015 (PayPal 2010).
- Quantum has also indicated that the overseas proportion of total online spend is 20 per cent (Pascoe 2011).
- Bell Potter/Southern Cross Equities (2011) estimated that around a third of online sales to Australian customers were made overseas (which equates to \$4.8 billion) in 2010.
- Citi Investment and Research (2010) estimated that online sales overseas account for somewhere between 30 and 38 per cent of total online sales or between \$3.5 and \$4 billion in 2010. More recent analysis by Citi using Customs data for the average value and volume of airmail and international mail in 2010 showed that the overseas share was more likely to be at the lower end of these estimates at around 30 per cent.
- Frost and Sullivan (2010) estimate that around 40 per cent of online expenditure in Australia was directed to overseas sites in 2010. A more recent report estimated that 44 per cent of online sales will be overseas in 2011 (which equates to \$6 billion) (PriceWaterhouse Coopers 2011).
- The Commonwealth Bank of Australia (CBA) estimated that around 46 per cent of online spending by Australian consumers in 2010 was undertaken overseas (CBA 2011).

To shed further light on the overseas share of online expenditure, the Commission analysed data provided by a major Australian bank which relates to the volume and value of online retail transactions by customers between June 2008 and February 2011. These transactions relate to purchases of retail goods using a credit card where the card was not physically present.

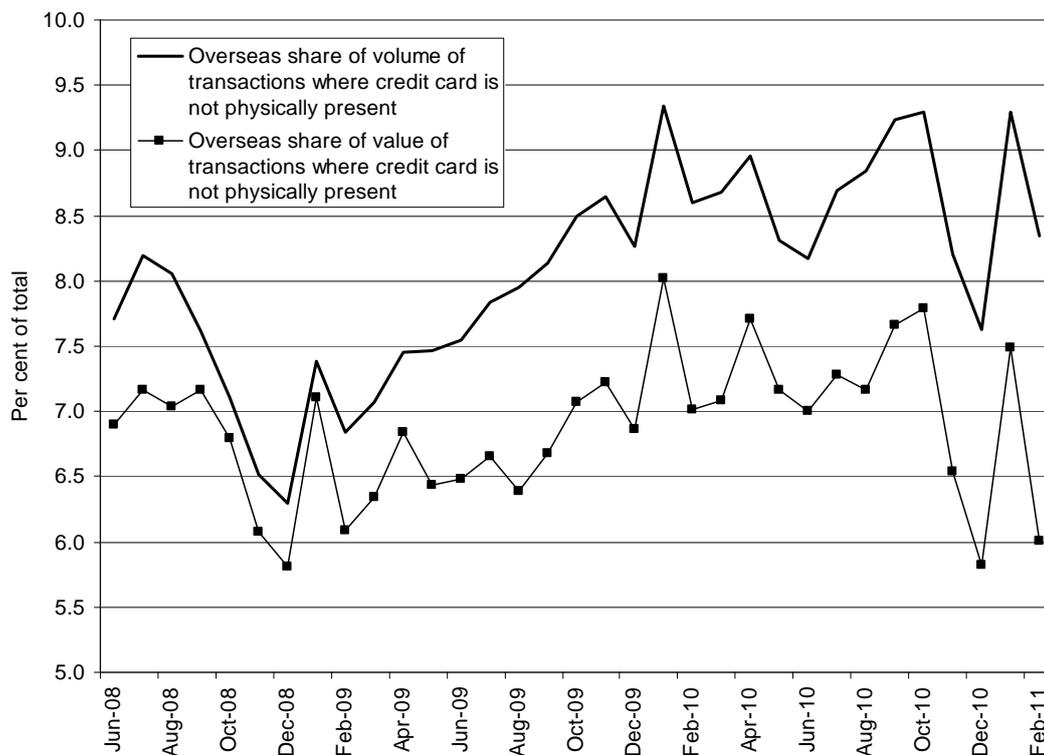
As well as transactions made by bank customers via the internet these data also include payments for retail goods where details are provided over the phone or mail. The phone or mail share of credit card transactions for items purchased from overseas is assumed to be relatively small. However there is less certainty about the breakdown between phone and internet purchases for domestic transactions. As a result, the estimates for volume and value of domestic online transactions may be overstated, but the extent is unclear. This may contribute to an understatement of the overseas share of total online activity. It should also be noted that these data do not include debit card transaction activity which has been growing rapidly — particularly through financial intermediaries such as PayPal.

Having noted these caveats, the data suggest that the overseas share of online sales may not be as significant as reported by some leading market analysts. For example,

purchases by bank customers from overseas websites of retail goods (excluding travel) where a credit card was not physically present accounted for only 7.5 per cent of the total value of all retail transactions (where the credit card was not present) in January 2011 and 9.3 per cent of the volume (or number) of online retail transactions using credit cards.

While data for the overseas share of total credit card transaction should be treated with some caution, the bank data show strong growth in the volume of both overseas and domestic retail purchases in the 12 months to January 2011 compared to the previous year — up by 16.9 per cent and 6.8 per cent respectively. The overseas share of the total number of retail transactions where a credit card was not present trended slightly upwards during 2010 but fell during the Christmas period, indicating relatively stronger growth in domestic online sales (figure 4.6).

**Figure 4.6 Overseas share of retail transaction activity of a major Australian bank where a credit card was not present, June 2008 to February 2011<sup>a</sup>**



<sup>a</sup> Transactions where a credit card was not physically present are a proxy for online transactions.

Source: A major Australian bank (unpublished data).

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## Market analyst estimates for total online spend in Australia

Estimates by market analysts for the total online share of total retail sales in 2010 range from a low of 3.8 per cent (CBA 2011) to a high of 7.2 per cent (Macquarie Equities Research 2011b) in 2010 (box 4.3).

Again, a number of differences exist in how market analysts construct the denominator of total retail sales and determine the overseas share of online sales. For example, Macquarie Equities Research include all online spend with the ABS estimate for total retail spend in deriving a synthetic estimate for total retail sales. In other words, the ABS is assumed to not capture domestic online sales in their retail trade data. Bell Potter/Southern Cross Equities do not include the leakage of overseas online sales in their estimate for total retail sales. The Commonwealth Bank of Australia (CBA) estimates are based on credit and debit card transactions of around 250 'pure play' online retail establishments and do not include online sales of multi-channel establishments. Forrester includes travel in their estimates while many of the other analysts exclude travel and event ticketing.

### Box 4.3 Market estimates for total online sales

- Citi Investment and Research estimated the purchase of goods from *domestic* websites at \$7.5 billion (or 3.1 per cent of all domestic retail sales) in 2010 while spending by Australian consumers at *overseas* websites was estimated at between \$3.5 and \$4.5 billion — which is equivalent to between 1.5 and 2 per cent of total retail spending. Adding domestic and overseas online sales together, total online sales accounted for between 4.5 and 5 per cent of all Australian retail sales or between \$11 and \$12 billion (Citi Investment and Research 2010).
- The CBA estimated a total online retail spend of \$9.5 billion in 2010 consisting of \$5.3 billion spent domestically and \$4.4 billion overseas. According to the CBA, this equates to 3.8 per cent of total retail spending and 5.2 per cent of 'discretionary spending' (defined as excluding food and liquor) (CBA 2011).
- Morgan Stanley estimate that online sales accounted for 4.7 per cent of all retail sales or \$12 billion in 2010 (Kierath and Wang 2011). Frost and Sullivan (2010) also estimate that Australia had total online sales of \$12 billion in 2010.
- Bell Potter/Southern Cross Equities (2011) provided an estimate of 6 per cent for total online sales share of all retail sales which equated to \$14.5 billion.
- Macquarie Equities Research (2011b) estimated that online sales accounted for 7.2 per cent of all retail sales or \$18.9 billion in 2010, while Forrester Research (2011) had a much higher estimate for total online spend of \$26.9 billion.

## Commission's estimates for total online retail spend

Based on the available data, and taking into consideration the differing methodologies employed by market analysts, the Commission considers that the domestic online share of total retail sales is at the lower bound of estimates by market analysts at around 4 per cent (or \$8.4 billion) in 2010. A third of total online sales are sourced from overseas. Around 2 per cent of total retail sales (or \$4.2 billion) is sourced from overseas online retailers. The Commission estimates that total online sales account for 6 per cent of total retail sales in Australia, and that Australian consumers spent around \$12.6 billion on goods purchased from domestic and overseas websites in 2010.

The Commission determined the estimates for domestic and overseas online sales using a total figure for domestic retail sales of \$210.8 billion in 2010, which is based on the ABS estimate for total retail sales (\$242.6 billion),<sup>4</sup> less turnover for cafes, restaurants and take away food services (\$31.8 billion) (ABS 2010h). Online sales from overseas (of \$4.2 billion) is then added to determine total retail sales of \$215.0 billion. Implicit in these calculations is the assumption that the ABS has captured domestic online retail sales (of \$8.4 billion) in their estimate for total retail sales which is distributed between the retail sectors. But the distribution of domestic online sales among retail sectors is unknown (table 4.1). Note that the online domestic spend is shown separately in the table in italics — if it was added to the retail categories this would result in double counting.

**Table 4.1 Retail sales including domestic and overseas online spend, 2010**

<i>Retail category</i>	<i>Sales</i>	<i>Share of total retail sales</i>
	\$ billion	%
Food	96.6	44.9
Household goods	42.8	19.9
Clothing, footwear and personal accessories	19.3	9.0
Department stores	18.6	8.7
Other retailing	33.5	15.6
Online overseas (est)	4.2	2.0
<b>Total retail sales <sup>a</sup></b>	<b>215.0</b>	<b>100.0</b>
<i>Online domestic (est)<sup>b</sup></i>	<i>8.4</i>	<i>4.0</i>

<sup>a</sup> Excludes sales of food from cafes, restaurants and take away services. <sup>b</sup> The online domestic spend of \$8.4 billion is distributed between all of the retail categories listed above the total (apart from online overseas). The manner in which it is distributed is unknown.

Source: ABS (*Retail Trade, Australia*, Cat. no. 8501.0, trend data); PC Estimates.

<sup>4</sup> Sales of fuel and motor vehicles are not included in ABS estimates for retail trade turnover.

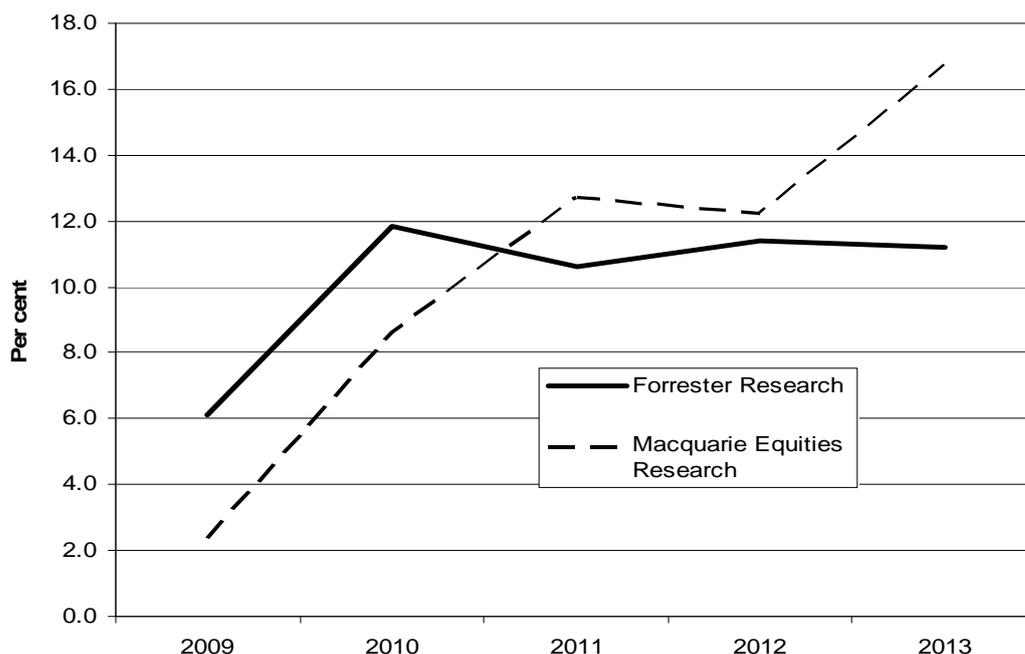
## Projections for growth in total online shopping

Online retail sales are expected by some analysts to grow by between 10 and 15 per cent per annum through to 2013 (box 4.4).

### Box 4.4 Projected growth in total online retail sales in Australia

- Forrester Research estimates that annual growth in total online retail sales will be between 10 and 12 per cent in the three years to 2013 (PayPal 2010). Macquarie Equities Research (2011b) predict much stronger growth in 2013, of 17 per cent.
- Forrester Research has estimated that total online retail sales in Australia (including domestic and overseas online sales) will grow from \$26.9 billion in 2010 to \$36.8 billion in 2013 (PayPal 2010). Macquarie Equities Research (2011b) has a lower estimate for total online retail sales of \$18.9 billion in 2010 which is expected to grow to \$27.9 billion in 2013.

#### Estimates of annual growth in online retail sales in Australia, 2009 to 2013



- Morgan Stanley expects the online share of total sales to increase from 4.7 per cent in 2011 to 8.4 per cent in 2015. The value of online sales is projected to increase from \$11.9 billion in 2011 to \$25.1 billion in 2015 (Kierath and Wang 2011).
- Frost and Sullivan estimate that online sales will increase from \$12 billion in 2010 to \$18 billion in 2014 (Frost and Sullivan 2010). In a more recent report, Frost and Sullivan estimated total online sales will grow by 13 per cent in the 12 months to 2011 to \$13.6 billion, when it would represent 5.5 per cent of total retail sales (PriceWaterhouseCoopers 2011).

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## **Lack of official statistics for online retailing**

For purposes of public policy, it is problematic that no official statistics are provided by the ABS on the size of online retail sales in Australia, both in terms of volume and value of transactions. The ABS Retail Trade survey captures data on sales from a range of retail establishments across Australia including non-store based retail which incorporates domestic online sellers. This would include spending by consumers with ‘pure play’ retail establishments. The ABS is currently unable to disaggregate spending with ‘pure play’ establishments from spending with other non-store based activities which have no relationship to online retail activities.<sup>5</sup>

The sales of the online divisions of multi-channel establishments are also not collected separately but are included in sales activity data of store based retailing, as this is the main activity of the majority of multi-channel establishments. As a consequence, it is not possible to disaggregate total domestic online sales from total retail sales in ABS retail sales data given the absorption of some online spend into store-based sales data. Additionally, the ABS does not capture data on the extent of purchases by Australian consumers from overseas websites. As a result, it is currently not possible to monitor trends in the overseas share of total online retail activity from official sources of statistics.

Similar concerns exist with the coverage of ABS employment data which relate to online sales. At present, it is not possible to disaggregate the level of employment associated with internet retailing (or ‘pure plays’) from all non-store based retailing. It is also not clear where employment in the online divisions of multi-channel establishments is being captured. Employment issues related to the retail industry are discussed in more detail in chapter 12.

Given the growing importance of this part of the retail industry, it is important that more precise statistics are available. The United States has been collecting official data for e-commerce retail sales for over a decade while the United Kingdom has been collecting official data on internet retail sales since late 2006. The results of these overseas survey findings are discussed later in the chapter.

Subsequent to the release of the draft report, the ABS provided a submission to the Commission which confirmed that turnover of ‘pure play’ and the online divisions of multi-channel retailers are captured in the ABS Retail Trade survey, but cannot be disaggregated to reveal growth in sales of online retailing as distinct from growth

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<sup>5</sup> The ABS includes the following activities in non-store retailing: direct mail retailing; direct selling of books, cosmetics and other items; internet retailing; milk vending; mobile food retailing; and vending machine operations.

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in sales of bricks and mortar establishments. Further, the ABS confirmed that the sales of pure plays are only one element of non-store retailing which also includes unrelated activities such as catalogue and direct selling. The ABS indicated that they were in the process of investigating methods of disaggregating retail sales information for domestic multi-channel and pure play online retailers (sub. DR164).

The ABS also indicated in their submission that international transactions, including online, were in-scope of their international accounts but could not currently be identified due to lack of data sources (sub. DR164, p. 4). The ABS is investigating how to improve the coverage of low-value imported and exported goods which are delivered online such as downloads of computer software, audio-visual material, e-books, and the provision of telecommunications and information services. The ABS is hoping to enlist the services of Australia Post, the Australian Customs and Border Protection Service, transport operators and payment agencies to assist in determining the value of goods purchased and sold online. The ABS emphasised that this data will be made available separately to existing international data releases and will not equate to the total value of online trade.

The ABS confirmed that research would be required to investigate methods and data availability for measuring employment of pure play retailers and the online and bricks and mortar workforces of multi-channel retail establishments. This exercise was expected to be both difficult and expensive. The Commission welcomes the initiatives being undertaken by the ABS to capture disaggregated data for domestic and online retail activity.

#### RECOMMENDATION 4.1

*The ABS should monitor and report online expenditure both domestically and overseas by Australian consumers. The ABS should also consider options that will enable the disaggregation of online spending and employment associated with ‘multi-channel’ establishments and ‘pure play’ online retailers.*

### **4.3 Estimates for online retail share of total retail sales in the United Kingdom and the United States**

A number of market analysts (Bell Potter/Southern Cross Equities (2011); Frost and Sullivan (2010); MacGowan (2011)) claim that Australia lags overseas countries such as the United States and the United Kingdom in terms of online share of total retail sales by two to three years. If so, the experience of those countries may provide an indication of potential growth in online retailing in Australia.

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Data show that Australians spend more per capita on online shopping than the United States but lag the online shopping spend of people in the United Kingdom. For example, Access Economics reported some comparisons of per capita e-commerce purchases which showed the United Kingdom leading at US\$1266 per capita in 2009, followed by Australia (A\$534 per capita in 2009 and A\$1068 per capita in 2010) and the United States (at US\$420 per capita in 2008-09) (Access Economics 2010). Note that these estimates relate to e-commerce and may include purchases such as travel and entertainment as well as retail goods.

One market analyst stated that online sales accounted for 7 per cent of all retail sales in the United States and 10.5 per cent of all retail sales in the United Kingdom. Australia was considered a relative laggard at 4 per cent of retail sales (Bell Potter/Southern Cross Equities 2011). The Centre for Retail Research in the United Kingdom, estimate that online sales in the United Kingdom account for 11 per cent of all retail sales and that the online share in the United States is between 8 and 9 per cent of retail sales (Centre for Retail Research 2011).

Estimates by market analysts for the online share of total retail sales in the United States are diverse and appear inconsistent with official statistics. The United States Census Bureau has been collecting official data on e-commerce retail sales since late 1999 based on the results of its Monthly Retail Trade Survey. The data show that the e-commerce share of total retail sales in the United States has been increasing very slowly over the past decade and stood at 4.5 per cent in the first quarter of 2011 in seasonally adjusted terms.<sup>6</sup> In original terms, the online share climbed to as high as 5.1 per cent in the fourth quarter of 2010 which reflect the seasonal impact of online purchasing pre-Christmas (figure 4.7).<sup>7</sup> In the past four years e-commerce sales as a proportion of all retail sales have only increased by 1.2 percentage points in the United States (United States Census Bureau 2011).

These estimates are much lower than those provided by market analysts. One possible explanation for the difference is the United States Census Bureau is only measuring domestic e-commerce retail sales as a proportion of all retail sales and it is not always clear whether the estimates by market analysts are also factoring in purchases by US consumers from overseas websites.

Official estimates for the online share of total retail sales in the United Kingdom show a much higher online share of total retail sales of 9.9 per cent recorded in June 2011 (in original terms) (figure 4.7). These official estimates are much more

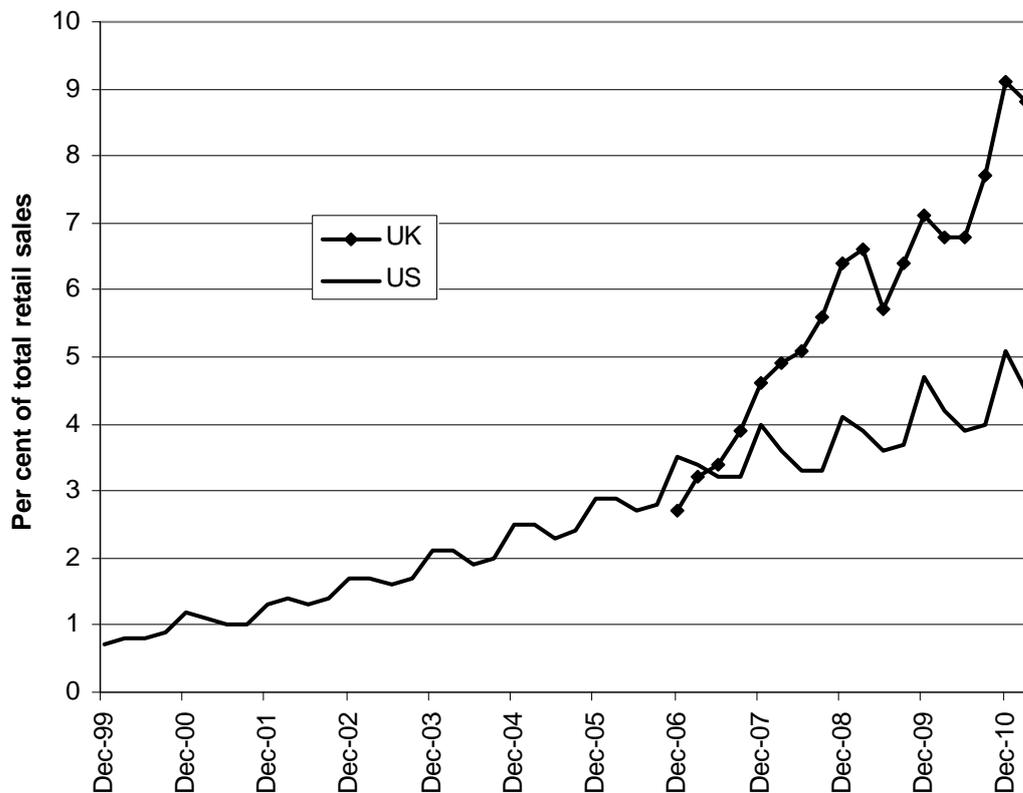
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<sup>6</sup> Retail e-commerce sales estimates apply to sales by firms based in the US and do not include sales by online travel services, financial brokers and dealers and ticket sales agencies.

<sup>7</sup> Original data are raw data that have not been smoothed to account for seasonal factors such as Christmas sales or trended to remove further variability resulting from irregular events.

consistent with those provided by market analysts. According to official data the domestic online share of total retail sales in the United Kingdom has almost tripled in the past four years (up from 3.4 per cent to 9.9 per cent — or a rise of 6.5 percentage points) (Office for National Statistics 2011).

**Figure 4.8 Online retail sales as a share of total retail sales in the United States and the United Kingdom, December 1999 to March 2011<sup>a</sup>**



<sup>a</sup> US data refers to e-commerce sales of goods and services made over the internet or other online systems as a percentage of all retail sales; UK data refers to internet retail sales as a percentage of total retail sales.

Source: US Census Bureau and UK Office for National Statistics; original data.

It would appear from this information that online purchasing from domestic retailers as a share of total retail sales is much higher in the United Kingdom than it is in the US. There also appears to be a steeper growth path for online retail sales in the United Kingdom than the United States. The data indicate that there is considerable capacity for online retailing to grow in Australia before it reaches rates and levels achieved in countries such as the United Kingdom. The online sales gap between Australia and the United States appears to be much smaller. Research undertaken by market analyst Citigroup show that the online share of non-food retail sales in

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Australia and the United States are very similar at 9.5 per cent and 9.4 per cent respectively (Citi Investment and Research 2011a).

#### **4.4 What is driving online sales?**

A number of factors have been identified in submissions and reports as drivers of growth in online sales in Australia in recent years.<sup>8</sup> These include:

- consumer response to lower prices available online
- appreciation of the \$A contributing to lower prices of imported goods
- convenience and availability of online shopping
- greater range of goods and services available online compared with bricks and mortar stores
- initiative shown by some web based companies that have invested in web interface technology and processes which facilitate online ordering, inventory stocktake and delivery
- more secure payments systems which give greater confidence to consumers to purchase online
- innovations in online selling — such as group sales and special daily deals
- emergence of m-commerce — the use of mobile devices to compare prices and features of products as well as make direct purchases
- a more computer literate population
- long term trends towards higher educational attainment among consumers and increases in real household disposable income — survey results demonstrate that better educated and wealthier people are most likely to take advantage of the benefits that can be obtained from online shopping.

eBay noted several factors which are driving growth in the number of online businesses. These include: low cost structures of online retail, such as not having to bear high rental costs; low barriers to entry in setting up an online retail business; and low barriers to geographic expansion across Australia and overseas. Sellers benefit from the internet's ability to connect with prospective buyers. Online retailers can reduce the amount of advertising needed to sell products and can

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<sup>8</sup> eBay (sub. 101); Choice (sub. 82); ACMA (2010); Irvine, B et al. (2011); Access Economics (2010); PayPal (2010); eBay (2011); Macquarie Equities Research (2011); Bell/Potter/Southern Cross Equities (2011); MacGowan (2011).

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interact directly with customers and avoid the need for intermediaries. These savings can be passed directly on to customers (sub. 101).

In a survey of 1000 consumers by market research consultants Frost and Sullivan, 39 per cent of respondents cited cheaper prices as the major driver behind their decision to purchase online, followed by 29 per cent who cited the convenience of shopping from home, 17 per cent who cited the more comprehensive range of goods available online and 12 per cent who cited the ease of looking for and finding the product they required (Frost and Sullivan 2010).

The Australia Institute found similar results from their survey of just over 1400 consumers. One of the questions framed in the survey allowed multiple responses for the major factors driving people to shop online. Around 85 per cent of people who shopped online were driven by price, 65 per cent wanted to compare products and prices, 64 per cent wanted to buy products which were not available in stores, 54 per cent wanted to save time, 36 per cent wanted to avoid travel and 32 per cent wanted to avoid shopping centres (Irvine, B et al. 2011). ACMA found from their survey responses a slightly different ordering of reasons why people purchase online, but again the factors were dominated by convenience, price and range of goods available (ACMA 2010a). With some slight differences in ordering of preferences, all of these survey results point to similar factors motivating consumers to purchase online.

## **Using the internet as a research tool**

The internet provides the opportunity for Australian consumers and businesses to gather information on the attributes of particular products and services, as well as being able to make price comparisons. This lowers search costs associated with purchasing activities. The resulting efficiencies are estimated at \$7 billion annually in terms of time saved (Deloitte Access Economics 2011).

Google described the most prevalent form of online shopping as ROPO — whereby consumers Research Online and Purchase Offline (sub. DR199). Research conducted by the Australian Centre for Retail Studies on behalf of Google found that around one half of Australian consumers conducted research on prospective purchases online before making their purchase. Further, a quarter cited researching online as the most crucial determinant of their offline purchasing behaviour — ahead of TV, radio, brochures and catalogues combined (Australian Centre for Retail Studies 2008).

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## 4.5 Characteristics of online purchasing

### What is the value of online purchases?

While the total value of online retailing is growing, the value of the individual items purchased online is typically low. Data sourced from a major Australian bank show that the vast majority of purchases by customers from overseas websites were valued at \$200 or less. For example, just over three quarters of goods purchased between June 2008 and February 2011 from overseas where the credit card was not physically present were valued at under \$100 and a further 12.8 per cent were valued between \$100 and \$200. In other words, just under 90 per cent were valued at \$200 or less (table 4.2). Furthermore, the average value of goods purchased online overseas was \$112 which compares with an average value of \$134 for goods purchased online locally in Australia. As will be discussed in chapter 7, the average value of air cargo consignments was similar at \$123 in 2010-11.

Table 4.2 **Distribution of overseas and domestic purchases where credit card was not physically present by value of transaction, June 2008 to February 2011**

<i>Value of transactions</i>	<i>Domestic</i>	<i>Overseas</i>
	(% of total)	(% of total)
< \$100	73.4	76.5
\$100 < \$200	14.7	12.8
\$200 < \$300	4.8	4.1
\$300 < \$400	2.1	2.0
\$400 < \$500	1.1	1.1
\$500 < \$1000	2.2	2.1
\$1000 < \$2000	1.0	1.0
\$2000 < \$3000	0.3	0.2
\$3000 plus	0.4	0.2
<b>TOTAL</b>	<b>100.0</b>	<b>100.0</b>

Source: A major Australian bank, (unpublished data).

### How many Australians shop online?

ABS data reveal that just under two thirds (64 per cent) of Australians aged 15 years and over in 2008-09 had used the internet to purchase goods or services in the previous 12 months — a slight increase from 61 per cent recorded in 2006-07 (ABS 2010g). Data from a survey conducted by ACMA in 2010 show a slightly higher

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proportion of Australians shopping online at 69 per cent (ACMA 2010a). A survey of 1000 Australians aged 18 years and over conducted by the Swinburne University of Technology reveal that 68 per cent had purchased goods online in 2011, compared with 41 per cent in 2007 (Ewing and Thomas 2010). Roy Morgan Research has been collecting information for over a decade on the use of the internet by consumers to purchase goods. Results of their surveys show that in September 2010 around a half of Australians aged 14 years and over purchased goods online in the previous 12 months, compared with only nine per cent a decade earlier (Roy Morgan Research 2011).

### **What are the characteristics of people who shop online?**

The use of the internet to purchase goods and services is strongly related to education and income and to a lesser extent age. All of the survey results show that wealthier and more educated people are more likely to shop online. (ABS 2010g; ACMA 2010a; Irvine et al. 2011; Ewing and Thomas 2010; MacGowan 2011).

Younger people (aged 17 years or less) and those aged 65 years and over are the least likely to shop online. People aged 20 to 44 years had a slightly higher propensity to shop online than those aged 45 to 54 years and a much higher propensity than those aged 55 to 64 years. Men were just as likely as women to use the internet to purchase goods and services (64 per cent versus 63 per cent), as were people from metropolitan and non-metropolitan areas (64 per cent versus 62 per cent). Around 78 per cent of people with a Bachelor degree purchased goods online which compared with 53 per cent of those with Year 12 qualifications or below. Also, 82 per cent of those in the highest equivalised income quintile purchased goods and services online compared to 42 per cent of those in the lowest equivalised household income quintile (ABS 2010g).<sup>9</sup>

### **What are people buying online?**

Despite some differences in ranking of importance, various survey results and market reports show similar types of goods are being purchased by Australians online. Goods most commonly purchased online include: DVDs and CDs; digital music; computer software and hardware; books; electrical and electronic goods; clothes and shoes; sports and leisure goods; cosmetics and perfume and toys

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<sup>9</sup> Equivalence scales are used by the ABS to adjust household income measures by the size of the household so that all households can be more readily compared. Household income is distributed among five quintiles — each quintile accounts for 20 per cent of the population.

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(ACMA 2010a; Forrester 2011; Irvine et al. 2011; Citi Investment and Research 2010; Nielsen 2008).

### **Online penetration by retail category in Australia**

While the domestic online share of total domestic retail sales in the economy is estimated to be around 4 per cent, the penetration of online sales varies considerably between merchandise categories. For example, Citi Investment and Research have estimated the online sales share of retail sales for books to be 9 per cent which is much higher than its estimate for the online share of total retail sales for all products (of 3 per cent) (figure 4.8). By comparison, its estimate for online share of groceries and alcohol sales is much lower at 1 per cent — despite a long gestation period of developing a market for online grocery sales (Citi Investment and Research 2010).

Data from Roy Morgan Research show that 12 per cent of all CDs, DVDs and hi-fi accessories purchased by respondents in the 12 months to June 2010 were accessed online. Results of the same survey showed that 11 per cent of book purchases were ordered online along with 6 per cent of electrical goods (Roy Morgan Research 2010).

Submissions from a number of bicycle retailers point to high penetration of online sales in bicycles and bicycle parts and accessory retailing.<sup>10</sup> Other submissions report strong online competition in outdoor and sporting equipment, toys, photographic equipment and clothing.<sup>11</sup>

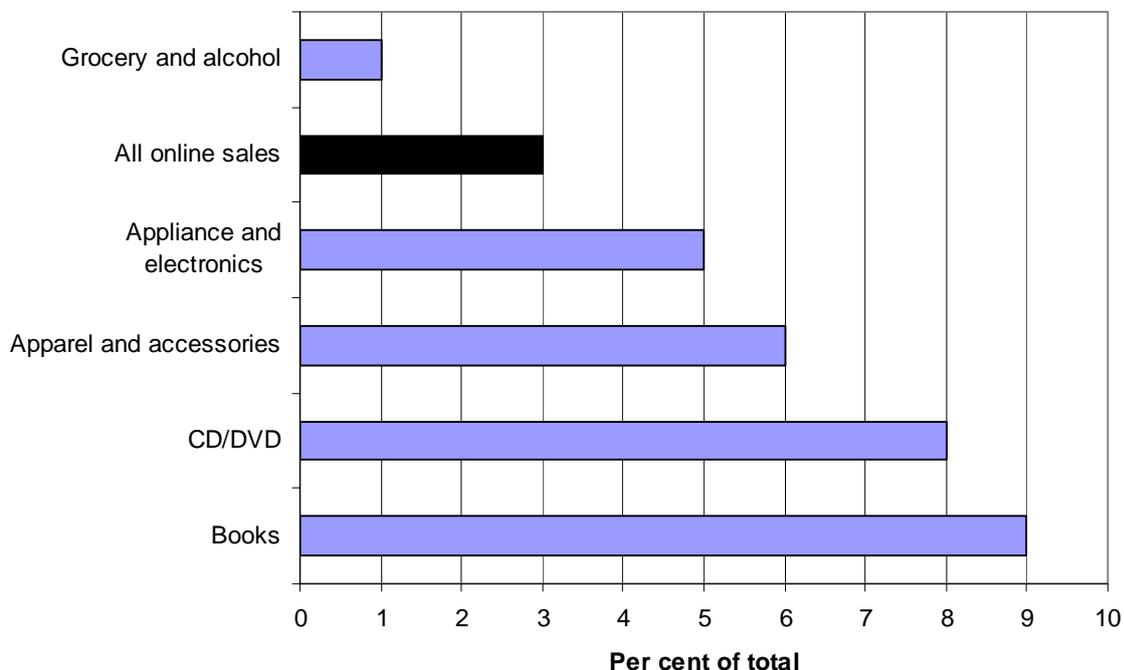
In its submission, Colony BMX Pty Ltd cite data from Quantum which show that 16 per cent of bicycle and bicycle-related products purchased by Australian consumers in 2011 are sourced online from overseas websites, which compared with 6.9 per cent in January 2010 (sub. DR169, p.1).

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<sup>10</sup> Renegade Cycles, sub. 34; Strictly BMX, sub. 35; Hyperdome Bike Hub, sub. 36; Backbone BMX, sub. 54; Yarra Valley Cycles, sub. 32 and ForTheRiders, sub. 55 and the Retail Cycle Traders Australia sub. 57

<sup>11</sup> Neil Blundy, sub. 50; Sporting Edge Australia, sub. 51; Wholesale Diving Supplies Pty Ltd, sub. 59; Frontline Hobbies Pty Ltd, sub. 19; Powerslide Racing, sub. 70; Photo Marketing Association, sub. 40; and Gusto Clothing, sub. 104.

**Figure 4.9 Online penetration of domestic sales by retail category, 2010<sup>a</sup>**



<sup>a</sup> The domestic online sales share of total domestic sales for all products of 3 per cent shown in the chart, against which other retail category penetration rates are compared is the estimate provided by Citi Investment Research and Analysis based upon their own assumptions and data sources. The Commission, as noted earlier, has arrived at a different estimate for the share of all domestic online sales (of 4 per cent). The analysis from Citi is an example of one set of estimates for online penetration rates in different retail categories.

Source: Citi Investment Research and Analysis (2010).

### Exposure of retail trade to overseas online retailing

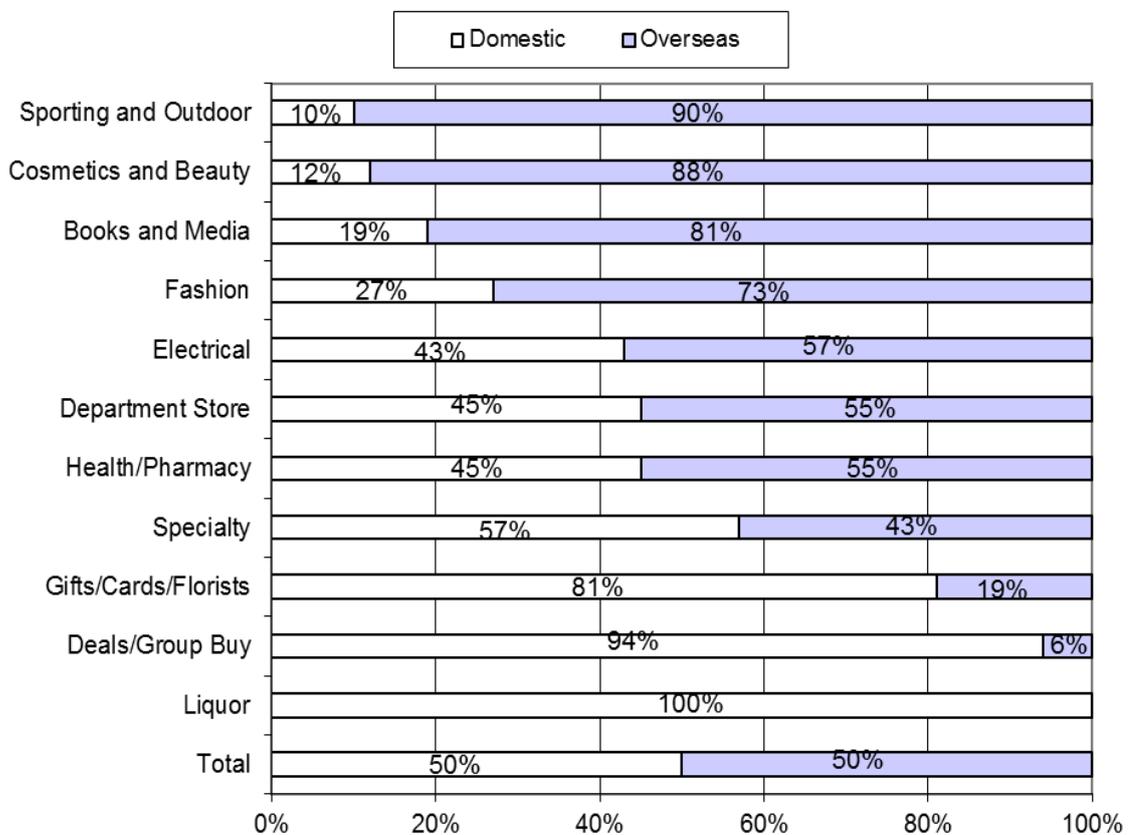
Employers in sectors such as household goods retailing; clothing, footwear and personal accessories; department stores; and other retailing are more likely to face competition from overseas online retailers than sectors of the retail industry which sell perishable foodstuffs.<sup>12</sup> When food retailing is subtracted from domestic retail turnover data, just over a half (54 per cent) of the retail industry in Australia could be regarded as trade-exposed (see table 4.1).

<sup>12</sup> Household goods includes electrical and electronic equipment, furniture, houseware, floor coverings, hardware, building and garden supplies. Other retailing includes newspaper and book retailing, recreational goods such as sport and camping equipment, toys and games, entertainment media, pharmaceuticals, cosmetics and toiletries, stationery goods and flower retailing.

Some sectors of retail are more exposed than others — particularly the selling of electrical and electronic goods, recreational goods, and clothing, footwear and personal accessories. ABS data show that household goods and clothing, footwear and personal accessories account for a quarter of all retail sales (ABS 2011g).

The Commonwealth Bank of Australia (CBA) analysed credit and debit card transaction data of 250 pure play retailers based in Australia and overseas where bank customer spending exceeded \$1 million (figure 4.9).

**Figure 4.10 Domestic and overseas shares of online sales by retail category, 12 months to May 2011<sup>a</sup>**



<sup>a</sup> Internal data sourced from 250 pure play retailers operating in Australia and overseas whose transactions exceeded \$1 million.

Source: CBA, (2011).

Among the results reported was a breakdown of the domestic and overseas share of online retail activities by various retail categories. The data showed an overall overseas share of total online sales in Australia of 50 per cent which is at the high end of the estimates reported by market analysts. The data show very high overseas shares of total online purchasing activity for items such as sporting and outdoor goods (90 per cent), cosmetics and beauty products (88 per cent), books and media

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(81 per cent) and fashion (73 per cent). Overseas online penetration was negligible in liquor (CBA 2011). These data provide further evidence that particular sectors in retail are more trade exposed to overseas online retailing than others.

### **Do Australian consumers prefer to shop at domestic or foreign websites?**

There is some conjecture over whether Australian consumers have a preference for using Australian or overseas websites to make purchases. Survey results point to Australians preferring to shop on domestic sites because of a perception of less risk and the ability to return goods more easily and for less cost, while other surveys indicate a preference for overseas websites because of a greater range of goods available and lower prices.

The results of an ACMA survey conducted in 2010 show that just over two thirds (68 per cent) of Australian consumers used domestic websites more often when making online purchases, 19 per cent were just as likely to use a domestic or overseas website, while only 12 per cent were more likely to use an overseas website.

The results of the ACMA survey show that the major reasons why consumers preferred to support a domestic website when making online purchases were:

- to support local industry (24 per cent)
- did not trust overseas websites (23 per cent)
- goods were only available locally (17 per cent)
- the goods were cheaper after taking into account shipping costs (14 per cent)
- it took too long for goods to arrive from overseas (11 per cent)
- it was easier to return a good if they had a problem (10 per cent).

The major reasons offered by respondents for preferring to purchase goods from overseas were:

- the goods were not available in Australia (56 per cent)
- the goods were cheaper (41 per cent)
- more variety of goods to choose from (13 per cent) (ACMA 2010a).

These results are supported by a separate survey conducted in 2011 by the Swinburne University of Technology which showed that of those persons who used the internet in Australia, just under 70 per cent preferred to shop on Australian sites (sub. DR179, p. 17). Of those who shopped online, two thirds reported that they

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purchased a half or more of their online purchases at Australian websites (sub. DR179, p. 19).

However, the results of a survey by the *Sydney Morning Herald* of almost 5000 respondents conducted in October 2010, show almost the opposite result with 70 per cent indicating they shopped mostly on overseas websites, 19 per cent shopped mostly with Australian online retailers and 11 per cent did not shop online (Zappone 2010).

Caution should be exercised in interpreting the results of the *Sydney Morning Herald* survey as there is a strong probability of self-selection bias for respondents. In contrast, respondents participating in the ACMA and Swinburne University surveys are randomly selected and more likely to be more representative of the Australian population.

The results of separate polling by Essential Research showed that consumers were fairly evenly divided between purchasing books from domestic or overseas websites, but were twice as likely to shop online domestically than overseas for retail items such as music and video, clothing and shoes, computers and accessories and cameras. The differential was far greater in favour of domestic online purchases for goods such as electrical appliances (three times more likely), furniture and wine and food (all six times more likely) (Whittaker 2011). Google also found that 80 per cent of the volume of queries on their search engine for retailer brand names in 2011 were domestic (sub. DR199, p. 5).

In summary, the results of the majority of surveys point to Australian consumers having a preference to shop with local websites rather than overseas websites, despite the fact that they may be able to purchase goods more cheaply and have a wider range of goods to choose from overseas.

## **4.6 The slow emergence of online grocery shopping**

The use of online grocery shopping in Australia remains low compared to countries such as the United Kingdom. Roy Morgan Research shows that while half of the Australian population had bought a product or service online in the 12 months to September 2010 only 2 per cent had bought groceries online in the past 3 months. The percentage of the Australian population purchasing groceries online is little changed over the past decade (Roy Morgan Research 2011). This is similar to the finding of the Australian Food News report that around 212 000 or 1.2 per cent of the population in Australia purchased groceries online in the 12 months to June 2009.

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As well as the major supermarket chains (Coles and Woolworths) a number of ‘pure play’ online grocery sites have emerged in Australia. Online grocery shopping has a number of advantages including time saving and convenience. In the case of some online grocery orders provided by bricks and mortar outlets, consumers have the option of either picking up orders or having them delivered. Also, online users are able to take advantage of a number of features of online shopping which include: being able to determine the cumulative spend as items are ordered on their computer; being able to arrange home delivery at a convenient time; and the ability to order at any time during the day or night.

Australian estimates for online grocery share of all groceries spend is relatively low at around 1 per cent (figure 4.8). This is significantly less than the online grocery spend rate in the United Kingdom and slightly less than the rate in the United States. Shoppers in the United Kingdom are much more likely to be involved in online purchases of groceries. Estimates of online grocery sales in the United Kingdom range from 3 to 4 per cent of the total grocery spend in 2010. In the United States, the online grocery share of total grocery sales was not expected to exceed 2 per cent during the three years to 2013 (IGD Retail Analysis 2011, Australian Food News 2010).

The slow take-up of online grocery shopping in Australia may be reflective of a combination of domestic supermarket chains being less aggressive in offering online services to Australian consumers and more entrenched consumer attitudes towards undertaking weekly grocery shopping at local shopping centres rather than online. This trend may change in the future as there appears to be distinct markets for online grocery shopping including a growing population of older consumers whose mobility is restricted and relatively affluent inner urban consumers who are attracted to time savings and convenience associated with online grocery shopping.

## **4.7 Rapid growth in m-commerce**

While online shopping has been facilitated by the greater household penetration of computers with broadband access it will be stimulated further by the growth in mobile devices such as phones with internet connectivity. It has been estimated that the number of mobile handsets with internet connectivity has tripled in the past year to around 3.6 million in June 2011. These phones now account for over one third (37 per cent) of all mobile phones in Australia (ABS 2011e).

Many online shoppers are attracted to the convenience associated with mobile devices though some concerns have been expressed about security. For example, just over three quarters of respondents to a Nielsen survey reported convenience as

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the major factor driving their use of mobile phones for transaction purposes, but over half were concerned that the mobile phone was not as secure as a desktop or notebook for making purchases. Another barrier to greater penetration of m-commerce is the usability of mobile phones to conduct transactions — almost half of consumers regarded the size of the screen as being too small and difficult to use. In other words, it can be physically difficult to enter large amounts of data into mobile devices. However, these identified shortcomings have driven innovative ways of converting searches for products into actual sales through more user friendly and flexible ordering and payment systems (PayPal 2011a).

Roy Morgan Research data show that younger people are more likely to use mobile phones for internet transactions — people aged 20 to 39 years accounted for 56 per cent of all users of mobile phones for online transaction activity in June 2010 (ACMA 2010b). The majority of m-commerce activity is conducted by those in high income brackets. Goods most likely to be purchased via mobile phones are typically lower priced and include clothing, books, music, computer software and video games.

Smart mobile phones allow consumers to make ready comparisons about features of products as well as the best prices available from bricks and mortar and online retailers. As well as providing information about products and relative prices, smart mobile phones facilitate the purchasing of goods online, which is expected to provide a further stimulant to online sales in the short to medium term.

## **4.8 Why has Australia lagged online sales of other countries?**

Some analysts report that Australia is lagging countries such as the United Kingdom and the United States in terms of take up of online shopping. There are a number of reasons for this. For example, countries such as the United States have a long history of mail catalogue purchasing which has translated into online purchasing as technologies changed. This sales format has not been as strong in Australia and some consumers have had to be convinced of the benefits of online shopping. Consumers in the United Kingdom appear to have an even greater appetite for online shopping than those in the United States and Australia. Evidence would suggest that once consumers have participated in an online shopping experience and have been satisfied with the results, this will translate into future purchases. Consumers are also more likely to shop online if they feel that financial security of transactions is assured.

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One market analyst provided a number of reasons for the lag in online shopping in Australia compared to the United Kingdom and the United States which included: the relative concentration of the Australian population in urban areas which have ready access to shopping centres and malls; higher broadband penetration in overseas countries; a greater range of online products and more efficient payment systems available from overseas suppliers; and low levels of investment in e-commerce infrastructure and product range in Australia (Bell Potter/Southern Cross Equities 2010).

Access Economics also noted a number of factors which could explain the slowness of Australian retailers investing in online facilities. These included: a lack of understanding of how e-commerce works along with its potential benefits; negative perceptions about the cost involved in setting up and maintaining web-based facilities; limited or unreliable broadband access and speed; lack of skills available to track sales online; inability to compete with overseas competitors online; and the perception by some of the larger retailers that they will lose the impulse buying from customers visiting bricks and mortar establishments (Access Economics 2010).

Some Australian retailers, particularly the larger department stores and large furniture, household appliance and electronic good retailers, have been relatively slow in entering or fully embracing the online retailing realm. While department stores such as Myer and David Jones and large retailers such as Harvey Norman have had an online presence for some time, their websites in the past appeared designed more to provide information on the range and specifications of goods they sell rather than to aggressively pursue online sales. David Jones was one of the pioneers in providing online services but then scaled back its operations in 2003 due to poor returns on its investment. It is unclear as to whether Australian consumers were not ready to embrace the benefits of online shopping at this time or the online facilities and associated marketing package provided were not sufficiently attractive to stimulate their purchasing behaviour.

For some multi-channel retailers, prices of goods offered on their online sites were often the same as those available in bricks and mortar shops. Other multi-channel operators, such as JB Hi Fi have become more actively involved in selling online by providing special price discounts for those consumers who shop online.

Larger retailers may have been reluctant to invest in fledgling online infrastructure given their already heavy investment in large retail shopping facilities. Forays into online shopping appear, in many cases, to have been undertaken in a defensive fashion as there is a fear of ‘cannibalising’ sales from traditional retail operations. In other words, the move into online retailing by some appears to be an attempt to

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protect market share from online sellers and other competitors rather than expanding their business. The development of online grocery sales by some of the leading supermarket chains is thought to be primarily of this nature. This is not unique to Australia, but the development and move to aggressively pursue online sales by bricks and mortar retailers appears several years behind experiences in the US and the United Kingdom.

Multi-channelling is becoming more prevalent. Recent examples include a revamped David Jones website, the development by Myer of the China based myfind.com website, and development of websites by Big W and Target. Westfield has also developed a cyber-shopping mall in which it hosts the portal for many retail brands. However, the investment in the venture is relatively small when compared with the size of their investment in shopping centres.

Despite recent growth, online sales only accounted for 0.2 per cent of all retail sales for Myer and David Jones in 2010-11. JB Hi Fi and Billabong had slightly higher online shares of total retail sales (at 1.5 per cent and 1.4 per cent respectively). Of the retailers analysed, Harvey Norman had the lowest online share at less than 0.1 per cent — until recently online sales for Harvey Norman have been restricted mainly to photo processing (Citi Investment and Research 2011c).

The online divisions of multi-channel retailers in the United States play a much greater role in driving sales than those operating in Australia. Overseas retailers such as Tesco and JC Penney's had much larger online shares of total retail sales at 3 per cent and 8 per cent respectively in 2010 (Citi Investment and Research 2010). More recent data show very high online penetration rates for US fashion stores such as Urban Outfitters (18 per cent), Abercrombie and Fitch (10 per cent) and Gap Inc. (9 per cent). There is more variability in penetration rates for US department stores with online sales accounting for 9 per cent of total sales for Saks, but only 2 per cent of total sales of Target and Costco, and 1 per cent of sales for Walmart (Citi Investment and Research 2011c).

In the United States, there appears to be a distinct inverse relationship between the number of stores and online sales penetration. With the exception of outliers such as Limited Brands and Gap Inc., a high online penetration rate correlates with relatively low numbers of physical stores. Citigroup have indicated that store numbers in Australia may fall in the future as retailers seek to consolidate their physical presence in stores with higher sales, while closing some of their non-performing stores and migrating some of their sales online (Citi Investment and Research 2011a).

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Google reported on retail experiences in the United States which demonstrate the strong market share of all online sales accounted for by multi-channel operators and the importance of an online presence to the bricks and mortar sales of multi-channel retailers.

Online technologies enable existing retailers with a physical presence to become multichannel retailers. Put simply, multichannel retailers service customers in store and online, giving the customer the freedom to choose how and when they want to interact. Overseas experience suggests that multichannel retail is a winning formula: 26 of the top 30 US online retailers are multichannel retailers with both a physical and online presence. The US department store Macys has been especially clear on the benefits of multichannel retail. Analysis of their loyalty card data demonstrated that for every \$1.00 of transaction data through their Macys.com presence, an additional \$5.77 of in-store purchases was influenced within the following ten days (sub. DR 199, p. 4).

Some sectors of the retail industry in Australia have witnessed the emergence of 'pure plays' who have developed market share without the need for physical retail outlets. The 'pure play' model has obvious advantages in terms of savings on rental costs and other overheads faced by bricks and mortar establishments with many store locations. Pure play retailers do not have to balance the risks of resourcing both bricks and mortar and online divisions of their businesses. But pure play models also face disadvantages such as not having an established brand name and customer base. Both multi-channel and pure play retailers need to respond to security and technical problems that may affect their internet sales. Sales over the internet also incur costs associated with warehousing, packaging and distribution. Some retailers, particularly smaller businesses with little knowledge of IT, may balk at the investment required to set up internet sales capability.

In summary, there appears to be scope for the growth and development of both pure play retailers and online divisions of multi-channel retailers in Australia. Survey results show that Australian consumers prefer to shop with domestic online retailers for a variety of reasons. Australian multi-channel retailers appear to have been fearful in the past of cannibalising their existing sales by pursuing online sales, but the overseas experience suggests that online sales can complement their bricks and mortar operations.

## **4.9 Constraints to online growth**

A number of submissions by retail employers and employer and consumer associations highlighted impediments to either starting up or expanding online shopping services. These impediments included: lack of knowledge as to how to start an online business, inadequate IT infrastructure, the high cost of parcel

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delivery in Australia, and shortages of employees with relevant IT skills and knowledge of web-based interface technology.

Choice refer to findings by IBISWorld that lower margins available online compared with bricks and mortar operations make it less attractive for bricks and mortar retailers to develop or expand online operations (sub. 82).

The Retail Traders Association of Western Australia stated:

Australian retailers have to a large extent ignored online trading through lack of knowledge and understanding on how to operate effectively online. Failure to understand the strategies required and the ongoing costs involved in establishing an online presence has seen many try and fail, to not want to try again. Unfortunately, it may appear to be a very simple project to go online, but it is far more involved and required access to extensive expertise and knowledge to sustain and manage an online presence (sub. 80, p. 8)

Retail Cycle Traders Australia noted a number of impediments to going online which may be reflective of the reasons why SMEs in particular may balk at investing in online infrastructure.

Setting up an online shop requires time and a commitment that many local shops simply do not have. There is often no value in doing so, nor any useful 'operating space' for the shop. The major online operators overseas have been in a business for a considerable time, and so dominate the market internationally, that there is no compelling reason for local shops to go online, other than to provide a convenience to customers. Some have done this, but they are not selling into the overseas market as restrictions such as freight costs and the Australian wage structure work against such a move (sub. 57, p. 5).

Stockland noted that online shopping in Australia is less developed than in countries such as the United States and the United Kingdom and offered some reasons for this including:

...the infrastructure, both IT and delivery of goods, in Australia is either underdeveloped or is expensive with such costs necessarily being passed on to consumers. Given the infrastructure costs, the economics of online retailing may not be justified (at this stage) for retailers with high volume, low margin business models (sub. 105, p. 6)

As reported earlier in the chapter, some submissions also highlighted deficiency in broadband speeds in Australia. However, this is not regarded as a major impediment to current levels of demand for online purchasing services.

The feedback from submissions would indicate some reluctance by Australian retailers, particularly smaller businesses, to invest in an online presence. While some may lack the resources and technical expertise to pursue online selling, others

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have embraced the challenge and are succeeding in gaining market share. While acknowledging the start-up costs involved in developing and maintaining web based facilities, there do not appear to be major barriers to entry to online sales for retailers. The following section examines the adequacy of product delivery infrastructure in supporting online selling.

### **Adequacy of product delivery logistics**

Submissions also pointed to inefficiencies and the relatively high delivery costs faced by consumers and retailers when purchasing and selling goods online. A key issue for online retailing is the satisfactory completion of consumers' online purchases — that is, an inexpensive, quick, reliable and convenient delivery of purchased products.

A thorough review of the efficiency of the parcel delivery system has not been conducted for some time. The Industry Commission conducted a review of mail, courier and delivery services in 1992 and found that Australia Post was performing relatively well in terms of productivity and financial results, but there was scope to improve the pricing of some services (IC 1992).

Australia Post noted in its submission that Australia has a fully competitive market for the delivery of parcels and it is only one of the players in the market. Australia Post also noted that it has responsibilities including being:

... required under its enabling legislation, the *Australia Postal Corporation Act 1989 (Cth)* and the Federal Government's *Governance Arrangements for Commonwealth Business Enterprises*, to conduct its operations, as far as practicable, in a manner consistent with sound commercial practices, to operate and price efficiently, to earn at least a commercial rate of return and in accordance with any applicable international treaties. These obligations are reflected in Australia Post's parcel pricing structure and its rates are not subsidised from other areas of its business operations (Australia Post, sub. 120, p. 1).

Australia Post stated in its submission that it could not determine whether some overseas retailers could be providing parcel services at a loss as part of a longer term strategy to grow market share. This makes it difficult to undertake meaningful comparisons on differences in delivery charges across countries. Australia Post also provided examples of where overseas retailers are bundling shipping costs into the retail price of their products which leads to the conclusion that consumers are paying for delivery costs through the final price paid on goods (sub. 120).

Australia Post also noted that they are bound by Universal Postal Union (UPU) payment arrangements in which they receive the same amount for processing

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inbound international mail irrespective of its actual costs of delivery. It was claimed that pricing may actually be lower than it should be if it were properly costed and based on sound commercial practice. Australia Post estimated that in 2010-11 it would make a loss of \$A1.06 per inbound international airmail packet (for those parcels weighing less than 2 kilograms) on a volume of around 39.7 million articles (sub. 120).

Australia Post cited examples of where it provides faster and cheaper prices for delivery of comparable items. For instance, a DVD carried by Australia Post from Melbourne to Sydney costs \$1.20 through its large letter service without tracking and takes one to four business days to deliver. By comparison, a DVD sent from New Zealand to Sydney by New Zealand Post using International Express with tracking costs \$26.82 and takes one to five business days. If New Zealand Post used International Economy without tracking to deliver a DVD its cost was lower (at \$3.66) but requires 10 to 25 business days (sub. 120).

Australia Post conducts its own consumer and business satisfaction surveys on the quality of its postal services (which includes parcels). Their survey results show 97 per cent of residential customers and 94 per cent of business customers were satisfied with Australia Post's letter and postal services in 2009-10 (Australia Post 2010).

While Australia Post point to indicators of customer satisfaction, a number of submissions included complaints about the adequacy of product delivery services. Ebay Australia and New Zealand noted in their submission following the release of the draft report that:

Based on its global experience, eBay suggests that Australia's domestic postal infrastructure, while improving through innovations made by Australia Post and express carriers, requires investment to upgrade and make cost-competitive the domestic postal delivery and tracking services to meet increasing consumer expectations and assure customers speedy delivery of the goods they buy online (sub. DR165, p. 3).

Other submissions which commented on the adequacy of the Australian postal system are summarised in box 4.5.

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**Box 4.5 Feedback from submissions on adequacy of product delivery services**

Allen Consulting Group cites the result of an Online Business Index survey which found that by far the major factor limiting the growth of e-commerce businesses was postage costs. Around 41 per cent of respondents said improved postal and delivery services would support the growth of online entrepreneurialism in Australia (eBay, sub. 101).

Freight costs between Auckland and Sydney were found to be cheaper than freight costs from Melbourne to Sydney for goods commonly purchased online such as DVDs and shoes (eBay, sub. 101).

Another feature which enhances the efficiency of postal delivery for online shoppers is tracked shipping. Buyers who purchase products that are shipped with tracking numbers have greater confidence that an item will be sent to the correct destination as well as the timing of its arrival. Australia appears to rate poorly against this criteria. According to Allen Consulting Group around 60 per cent of postal items in the United States have tracked shipping compared with around 10 per cent of postal items in Australia (eBay, sub. 101).

ANRA claims that Australian retailers face relatively high transportation costs when importing goods for their stores. They also highlight the necessity for a reliable transport network to allow goods to be transported quickly across major metropolitan cities and between cities and regional areas. Traffic congestion is seen as a major impediment to the industry as well as having to deal with multiple regulatory regimes when transporting goods interstate (ANRA, sub. 91).

Woolworths reported a number of logistic challenges to online retailers in Australia, however, postal deliveries do not appear to rate highly as an impediment:

Other challenges have included Australia's geography (which makes postage of goods ordered online more expensive) and the fact that, until recently, the sophistication of Australia's postal delivery system has lagged overseas. It is only recently that infrastructure has been put in place that enables customers and retailers to have broad / cost-effective access to reliable real time tracking of goods ordered online (Woolworths, sub. 110, p. 11).

Choice notes survey results related to online shopping which showed the lowest satisfaction scores were recorded for cost and delivery times for products ordered from Australian online retailers — with some noting that it would be faster and cheaper to order from overseas (Choice, sub. 82).

(Continued next page)

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#### Box 4.5 (continued)

Another submission suggested that there is a substantial cost hurdle faced by online retailers in Australia compared with similar retailers in countries such as the United States. These include freight, duty and local handling charges on wholesale imports (Gilmour's Pty Ltd, sub. 43).

##### Westfield notes:

Without knowing the full "end to end" costs of the logistics supply chain, the items' purchase price and other factors, it is not possible to determine the true logistics costs and overall profitability of the transaction. From a shopper's perspective however, it appears that it can cost as much to ship a product from Melbourne to Sydney as it does from the UK to a destination in Australia. (Westfield, sub. 103, p. 8)

##### A diving goods supplier states:

Retailers have the frustration in the fact that that if they do not have a product in stock the customer can buy it from the US and have it delivered to their door quicker than the local retailer could buy it from us in Brisbane, have it shipped to Melbourne and then supplied to the customer

... our experience is that back freighting goods to the US is still almost double the price (of importing). Therefore, Australian online retailers do not really get the opportunity to export their goods to other markets as the back freight is too high. (Wholesale Diving Supplies. Pty Ltd, sub 59, p. 2)

##### Retail Cycle Traders Australia report:

Local freight rates do not compare well with overseas rates. For all but the smallest and lightest items freight from the UK is considerably cheaper than Australian rates, especially considering the distance involved. When it comes to larger and bulkier items the comparisons are even further in favour of overseas dealers. (Retail Cycle Traders Australia, sub. 57, p. 5)

##### Woolworths comments that restriction on transportation act as an impediment to retail:

Time of transportation and type of transportation restrict retailer's ability to efficiently move products around and between states/territories, a challenge that is exacerbated by remote locations, longer distances, climate fluctuations and the topographical challenges of Australia. These transportation restrictions impact on customers by increasing the price of products and preventing stock from being available when stores open. (Woolworths, sub. 110, p. 37)

##### An importer of sporting goods notes:

... two to three hours a week are spent tracking goods being imported and trying to find goods that have been misplaced. We feel that shipping companies should be made more accountable for the goods they lose, and that perhaps this will encourage them to make their systems more reliable and efficient. (Sporting Edge Australia, sub. 51, p. 2)

According to the CEO of Australia Post 'though the internet has quashed the need for snail mail, with Australia Post handling only five billion items of mail, compared to the 27 billion texts and 400 billion emails last year, the company increased its parcel business by \$176 million in 2009-10 compared to the previous

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financial year' (Australia Post 2010). More recently it was reported that Australia Post recorded \$1.36 billion in revenue from parcel deliveries in 2010-11 with around 70 per cent of this revenue generated from e-commerce. Revenue from delivery of parcels associated with internet shopping was expected to more than double over the next five years. Parcel revenue was expected to reach \$2.5 billion in 2015 (Switz Super Report 2011).

Australia Post also reported that in terms of delivery efficiency, 96.8 per cent of large parcels, 95.9 per cent of small parcels and 99.3 per cent of Express Post items were delivered on time in 2009-10 (Australia Post 2010).<sup>13</sup>

The growth in parcel deliveries associated with online shopping is creating problems such as shortage of space to store items at post offices (AFR 2011) arising in part from the failure by mail contractors to deliver all items the first time. It is estimated that between 10 and 15 per cent of delivery attempts fail at the first attempt (ParcelPoint, sub. DR201), mainly because of the unavailability of the customer at the receiving address. Undelivered Express courier parcels are returned to their major depots which involves longer travelling times for customers. These circumstances impose transport and time costs on to customers to seek other arrangements to pick up parcels. This situation has created an opportunity for businesses such as ParcelPoint to offer an alternative shipping address for online purchases (such as newsagents or convenience stores) for which they receive a small commission from the point of collection.

A number of logistics initiatives have been announced by Australia Post to facilitate online shopping. An example is the trialling of 24 hour access electronic parcel lockers in Sydney, Melbourne and Brisbane which enable customers to pick up packages at any time of the week following the receipt of SMS notification. This service is expected to be expanded to 24 locations by the end of November. Another recent initiative announced by Australia Post, in association with eBay, is the provision of satchels and boxes priced at a low flat rate to anywhere in Australia regardless of geographic location. Australia Post also announced the availability of a new international tracked parcel product titled 'Pack and Track International' which is cheaper and provides tracked delivery between the United States and Australia, with more international destinations to be added in the future (Australia Post 2011).

Responding to the draft report, eBay Australia and New Zealand further emphasised that deficiencies exist in Australia's domestic postal infrastructure and noted that

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<sup>13</sup> 'On time' is defined as a parcel reaching its destination within 1 to 5 working days after being lodged.

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Australia ranks relatively poorly at 18<sup>th</sup> in the Top 20 Countries Global Logistics Performance Index Ranking (sub. DR165).

The World Bank's Logistics Performance Index (LPI) is much broader than an appraisal of the local parcel delivery system so it provides an indication of the efficiency of both Australia Post and private couriers. The index takes into account elements such as efficiency of the customs process; quality of trade and transport-related infrastructure; ease of arranging competitively priced international shipments; competence and quality of logistics services; ability to track and trace parcel consignments; and timeliness of shipments (World Bank 2010). While eBay noted that the logistics index showed Australia ranked rather poorly against wealthier countries, it recorded a similar overall score for logistics as countries such as France, the United States and Canada. Australia was ranked 3<sup>rd</sup> against ease of arranging competitively priced international shipments, 14<sup>th</sup> in terms of the efficiency of its customs processes and between 17<sup>th</sup> and 20<sup>th</sup> against the other four criteria.

The very high ranking of Australia for ease in arranging competitively priced international shipments would appear to indicate that domestic suppliers and customers have little difficulty in arranging relatively low cost shipments of parcels for import or export when compared with other countries. While this information appears to contradict some of the negative feedback about the performance of the parcel delivery system included in some submissions (see box 4.5), the index also showed Australia ranked lower in terms of domestic logistic services at 17<sup>th</sup> out of 155 countries, which confirms some of these concerns. Factors taken into account to determine the ranking for domestic parcel services included the time taken and cost of transporting items from factories of origin to a buyer's warehouse and from a port of discharge to a buyer's warehouse (World Bank 2010).

In summary, there are a number of negative comments made in submissions and reports about the efficiency of the current postal delivery system in Australia and the vast majority are directed at Australia Post. There is only limited evidence in submissions of specific concerns with private couriers. This finding needs to be put into context given that Australia Post has such a large share of the B2C parcel delivery market and has a community service obligation to deliver to rural and remote areas of Australia which may be deemed as unprofitable areas of business for private couriers. Delivery times to reach these destinations are much longer than metropolitan deliveries. Despite these caveats, it is clear that some customers are dissatisfied and relative prices and delivery times are major issues of concern.

Australia has its population spread over vast distances which presents challenges to both Australia Post and express courier services. Parcel delivery is a competitive

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market and if one participant were deemed by consumers and businesses not to be providing a high quality service at least cost then an opportunity would be provided to competitors to increase their share of a rapidly growing market.

While information available on the efficiency of existing parcel delivery systems is limited, it would indicate that the current parcel delivery system is able to cope with current levels of activity, albeit not as efficiently as some other advanced countries. This situation could change quickly given the expected strong growth in online shopping. Considerable investment in infrastructure such as warehousing and electronic processing of parcels will be necessary to expand the capacity to deal with increasing parcel volumes.

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## 5 Consumer protection

### Key points

- Consumer protection has become more complex as consumers have moved into online shopping, especially with overseas suppliers.
- The consumer protection provisions of the *Competition and Consumer Act 2010* apply to online traders in the same way as they do to bricks and mortar retailers. However, these provisions may not apply to overseas online transactions and, where they do apply, they are difficult to enforce in other jurisdictions.
- Despite this, the Australian Competition and Consumer Commission (ACCC) has taken action to enforce Australian consumer protection laws against overseas based traders and has had some success in obtaining a judgement and having it enforced.
- Cooperation with overseas regulators is becoming increasingly important in this regard due to the growth in cross-border transactions and the exposure of consumers to more complex transactions occurring across multiple jurisdictions.
- While goods purchased from overseas online traders may not meet Australian safety standards, regulators appear to be handling related concerns within their current compliance and enforcement frameworks. With the potential increase in online shopping, consideration needs to be given to both the tools available for the most effective overseas cooperation and the scale of the surveillance and monitoring task.
- As overseas online purchases are generally outside the scope of the Australian Consumer Law (ACL) provisions relating to warranties and refunds, local retailers and their suppliers can face a dilemma about whether or not to service or honour a warranty on a product they did not sell or risk negative publicity. Such issues are best addressed through a combination of consumer education and market based responses, such as a business model which provides advice and support to online consumers for a fee or through a new form of warranty.
- In recognising that a lower priced product purchased online from an offshore supplier may not be subject to Australian consumer protection laws, some consumers appear to be willing to 'trade off' the potential risk of product failure or defects for the lower price. Others may be unaware that they are not protected by Australian consumer protection laws.
- Online service providers are responding to the demand for secure online transactions and consumers are becoming more aware of the need for increased prudence in online dealings regarding their financial and personal information.

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## 5.1 Australia's consumer protection laws and online retailing

Consumer protection in Australia is based on a suite of policies and a legislative framework that aims to protect consumers from unconscionable or deceptive conduct and unsafe or defective goods and services. This also provides consumers with remedies when they suffer loss from such conduct or products as well as ensuring they receive appropriate product information to assist in making purchasing decisions.

Consumer protection has become more complex as retail activity has moved into online sales, and especially overseas online sales. Issues related specifically to online retailing include the security of the online payment process, theft of personal information (identity, financial and medical) and invasion of privacy (such as tracking of internet search habits and purchasing profiles). There are also new practices specific to the internet such as spam, spoofing, phishing, spyware and cookies, which can be manifested as annoyance and/or impaired performance of computers.

Online consumers may also experience problems similar to the offline environment, such as: delayed, undelivered and defective orders; mistakes in billing; warranty disagreements; misleading advertising; and deceptive and unconscionable conduct. Further difficulties may arise for online consumers in seeking redress and for effective regulatory enforcement, particularly for cross-border disputes.

Much of the focus of participants' concerns in this inquiry has been on compliance with Australian product safety standards of goods purchased online from overseas suppliers. Further concerns relate to the warranties attached to such goods and the availability of refunds.

### **The Australian Consumer Law and its application to online trading**

The implementation from 1 January 2011 of the Australian Consumer Law (ACL), as a schedule to the *Competition and Consumer Act 2010* (the Act) essentially replaced 17 existing national, state and territory laws with a single national law to make consumer protection consistent across the country.

Generally speaking, the Act applies to online traders in the same way as it does to bricks and mortar businesses. Further, sections 5(1) and 5(2) extend the application of the ACL and certain other parts of the Act to conduct that is engaged in outside of Australia in particular circumstances, including if the party engaging in the conduct is 'carrying on business within Australia'. This has been interpreted by the

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courts to include certain internet sales from businesses based overseas with no physical presence in Australia, where they were ‘carrying on business within Australia’ at the time the breach occurred (ACCC pers. comm., 10 June 2011). ‘Carrying on a business’ is not comprehensively defined in the Act, but is given meaning in case law.

Nevertheless, the Australian Competition and Consumer Commission (ACCC) has made it clear that the consumer protection provisions of the legislation may not protect consumers in all aspects of their online dealings with overseas based businesses (ACCC 2011d). State and territory consumer affairs and fair trading departments also make it clear to consumers that Australian consumer protection laws may not apply when making purchases from overseas online businesses. For example, Fair Trading Queensland notes:

... when dealing with businesses in other countries, Queensland and Australian protection laws may not apply. (Fair Trading Queensland 2011, p. 2)

In circumstances where the consumer protection provisions of the Act have been interpreted by the courts as applying to a transaction involving an overseas based online trader, there are likely to be practical difficulties in enforcing the law and obtaining a remedy for any breach.

## **Enforcing the consumer protection law in overseas jurisdictions**

Enforceability of Australian laws in foreign jurisdictions is complicated by the general principle that ‘the courts of one country will not enforce the penal and revenue laws of another country’ (*ACCC v Yellow Page Marketing BV (No 2)* [2011] FCA 352 at 77). It is also more difficult to secure the information necessary for legal action when the offence has occurred overseas. Despite this, the ACCC has taken action to enforce consumer protection laws overseas and has had some success in obtaining a judgement and having it enforced against overseas-based traders (box 5.1).

Given these difficulties, cooperation with overseas regulators is required. This international cooperation will become more important due to the increasing scale of cross-border transactions and consumers becoming exposed to more complex transactions occurring across multiple jurisdictions.

### *How Australia cooperates with overseas regulators*

The ACCC engages closely with competition and consumer protection agencies around the world in relation to cross-border conduct that may breach the Act. It

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undertakes a range of activities with its international counterparts including both cooperation on specific cases and more general exchanges of information on matters of common interest. Such activities are facilitated through the International Consumer Protection Enforcement Network (ICPEN) which consists primarily of the main consumer enforcement agencies in a range of countries.

### **Box 5.1 ACCC action against overseas-based traders**

The ACCC has taken action against overseas-based traders for breaches of the *Competition and Consumer Act 2010*.

- In August 2003, the Federal Court declared that an imitation Sydney Opera House website which operated out of the United States had misled and deceived consumers, following allegations that several consumers from the United Kingdom and Europe who tried to buy tickets through the site, and had their credit cards charged, were either overcharged or did not receive the tickets:
  - the ACCC obtained an injunction requiring the operator to remove the site from being accessible to Australian users.
- In December 2008, the Federal Court declared that the operators of the Designer Brand Outlet website, based in China, had made false, misleading and deceptive representations on their website, including claims that genuine designer label women's clothing was for sale, when in some cases no items were supplied, and in others the clothing was counterfeit. The court also granted injunctions restraining the operators from engaging in similar conduct for five years and they were ordered to pay the ACCC's legal costs:
  - the ACCC also brought action for compensation on behalf of consumers misled by the website operators. A subsequent financial settlement included payment of money to the ACCC for consumer refunds.
- In May 2010, following proceedings taken by the ACCC, the Federal Court found that e-commerce marketing companies StoresOnline International Inc. and StoresOnline Inc. made misleading and deceptive representations regarding the price of their products and services:
  - this was the second such case brought by the ACCC against StoresOnline
  - an additional aspect of this matter was resolved in December 2009 when the Federal Court found that StoresOnline had failed to comply with undertakings provided to the ACCC in April 2006, and made orders by way of declarations and injunctions relating to these breaches. StoresOnline admitted to the breaches and consented to the court orders being made.
- In April 2011, the Federal Court imposed penalties totalling \$2.7 million against two overseas companies, Yellow Page Marketing BV and Yellow Publishing Limited, for sending thousands of Australian businesses misleading faxes and invoices in an attempt to obtain subscriptions to their online business directories.

Sources: ACCC (2003, 2008a, 2008, 2009b, 2010b, 2011a).

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Cooperation is also occurring bilaterally through arrangements with Australia's counterpart agencies in a number of jurisdictions, including Canada, the United Kingdom, the United States, Korea, New Zealand, Taiwan and Papua New Guinea. Such arrangements provide a basis for case notification, information sharing, coordinated enforcement action and regular meetings. The *Mutual Assistance in Business Regulation Act 1992* enables the ACCC to assist overseas regulators in civil cases through the gathering of evidence even where the ACCC does not have an active investigation (ACCC, pers. comm., 10 June 2011). Similar international arrangements are used in the regulation of financial services. The Australian Securities and Investment Commission (ASIC), as Australia's corporate, markets and financial services regulator, has similar bilateral and multilateral arrangements in place, as well as provisions for the release of confidential information, to assist its regulatory surveillance and deterrence work (ASIC 2011).

A number of governments have also established the dedicated website eConsumer.gov as a portal for cross-border consumer complaints concerning online and related transactions (ICPEN 2011). This site featured in the Designer Brand Outlet case brought by the ACCC in 2008 (box 5.1). The case involved cooperation from a number of governments and other parties including the US Federal Trade Commission (FTC) and the UK Office of Fair Trading, as well as a domain name registrar and a major bank.

## **5.2 Product safety and warranty issues in online retailing**

Australia's consumer protection arrangements encompass an array of mechanisms that are designed to encourage suppliers to market products that meet reasonable standards of quality and performance, including statutory and common law rights to refunds and compensation in the event of injury or loss from defective products. Importantly, all reputable businesses (including those operating online) have strong incentives to develop appropriate systems to respond to consumer concerns so that they can encourage repeat business. Online retailers based offshore have similar incentives.

In the online retailing environment, these incentives are reinforced by independent third party supplier ratings such as eBay and customer feedback on product quality and after sales service and experience. A recent survey of online purchasers found wide involvement in such feedback, with most consumers reading other consumers' opinions about products and brands via social media, close to half commenting on brands, products or services and one-third posting online reviews (Nielsen 2011a).

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## Current concerns about product safety in overseas online retail

Product safety concerns raised in submissions focused on goods purchased online from overseas suppliers. These concerns covered a range of goods including medicines, bicycle parts and accessories, toys, body jewellery, electrical goods and motor vehicle components (box 5.2). Essentially, the concerns focused on:

- the potential harm to consumers from the lack of enforcement of Australian statutory requirements (rather than the requirements themselves)
- the cost disadvantage for domestic retailers compared to their overseas competitors.

In highlighting the potential harm to consumers, Lindysgoodies said:

OS [overseas] companies can trade in goods that may be banned or illegal without any fear of penalty. ... Furthermore products that may harm health such as external battery vibrating tongue bars are not monitored or regulated in any manner. (sub. 24, p. 3)

A number of submissions called for mandatory Australian product standards to be enforced on overseas online retailers by Australian regulators (Australian National Retailers Association, sub. 91; Photo Marketing Association, sub. 40; Myer Holdings Limited, sub. 88; Photo Imaging Council of Australia, sub. 27; Australian Automotive Aftermarket Association, sub. 38; Retail Cycle Traders Australia, sub. 57; Pharmacy Guild, sub. 72; Australian Music Association, sub. 68; Bicycle Industries Australia Ltd, sub. 53). In relation to medicines, the Pharmacy Guild made a number of suggestions towards a higher level of enforcement, including increased public awareness via education programs, and regular checks and monitoring of internet sites selling medicines (Pharmacy Guild, sub. 72).

The Australian National Retailers Association (ANRA) made the following recommendation:

... [that] the Australian Government takes steps urgently to ensure all goods being imported into Australia, including direct purchases by households, meet all Australian safety standards and labelling requirements. (ANRA, sub. 91, p. 35)

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### **Box 5.2 Participants' concerns about product safety**

Participants have raised safety concerns across a range of retail products sourced online from overseas.

- The Pharmacy Guild (sub. 72) has expressed concern about the use of medicines purchased on the internet by consumers without advice from a health professional. There was also concern that these products may contain potentially harmful ingredients.
- The Australian Toy Association (sub. 84) raised concerns surrounding the safety implications of transmitters and receivers purchased online from overseas retailers that operated on different frequencies to those approved for use in Australia.
- A number of bicycle retailers have expressed concern about the lack of enforcement of Australian Standards on overseas online sales of bicycle helmets and parts, which are enforced domestically under the 'threat of heavy fines' (Retail Cycle Traders Australia, sub. 57, p. 6). Other participants have raised similar concerns in relation to formulated hygiene, cosmetic and specialty products (Accord, sub. 75), equipment for rock climbing and vertical access (Neil Blundy, sub. 50) and motor vehicle components (Australian Automotive Aftermarket Association, sub. 38).
- The Australian Dental Industry Association raised concerns that many potentially high risk medical devices such as autoclaves, tooth filling materials and other medical equipment could be imported into Australia via the internet without any safeguards as to their fitness for use (sub. DR142).
- Importers and retailers of electrical goods have also pointed to the competitive disadvantage they experience when Australian safety standards are not enforced on imported goods (and the costs of adapting goods avoided), as well as the risk to consumer safety (Photo Imaging Council of Australia, sub. 27; Photo Marketing Association, sub. 40).

As well as the potential harm to consumers, importing products that do not meet Australian Standards can also place Australian retailers at a competitive disadvantage.

For example, Bicycle Industries Australia (sub. DR155) highlighted the cost disadvantages to Australian retailers in having to meet Australian Standards in comparison to their overseas competitors. It noted that an Australian importer of bicycle helmets not only had to pay the GST on the imported helmets, but also had to meet the costs of the engineering fees to test the helmet to Australian and New Zealand Standards. Further costs include the applications fees and the standards approved labels. Sacred Ride Jindabyne said:

Australian bicycle helmet suppliers as an example are forced to pay up to \$25,000 per year prior to importing a single helmet, with additional costs associated with testing

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and assessing each batch of helmets delivered with many paying over \$100,000 per annum in testing and likening fees to meet Australian Standards. (sub. DR200, p. 2)

These costs were associated with Australia (and New Zealand) having a unique standard in this area.

Due to the current standards, introduced in 2008, the majority of helmets constructed for the European and American markets do not pass Australian testing protocols. (sub. DR155, p. 6)

Consequently, bicycle helmets that meet European or US standards have to be modified and/or retested to meet the current Australian Standard and labelled appropriately. Bicycle Industries Australia went on to say that:

If an Australian retailer supplies a helmet that has not been tested to current Australian Standards, and labelled appropriately, that retailer faces a fine of up to \$1.1 million and the individual staff member faces a fine of \$220,000. ... These helmets [not tested to Australian standards] are illegal to use on Australian roads. (sub. DR155, pp. 6-7)

Some have questioned the broader implications for the consumer protection framework:

At times (such as with non-compliant electrical goods) these policy settings actually lead to genuine health and safety implications for Australian consumers. It may be that as a society these are risks which we wish to allow our citizens to take - but if that is the case, why did we build such a strong consumer protection framework in the first place? (Australian Music Association, sub. 68, p. 4)

While the Australian Dental Industry Association questioned whether the current regulatory framework — particularly in respect of the importation of medical devices — was becoming increasingly irrelevant in the twenty first century (sub. DR142).

## **Australia's product safety arrangements**

The existing consumer protection regulatory framework has safety as a central concern and a number of product safety standards are mandatory. The ACL requires mandatory notification to the ACCC by businesses where they become aware that one of their products has caused illness, injury or death.

While the ACL and the ACCC play a central role in product safety, a number of other agencies are also involved in the regulation and enforcement of safety standards for specific products such as electrical equipment and therapeutic goods and, in the case of financial products, protecting consumers more generally. In many cases, these agencies work in conjunction with the ACCC (box 5.3).

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### Box 5.3 **Consumer protection and product safety — who does what?**

Consumer products: The Australian Competition and Consumer Commission (ACCC), in conjunction with state and territory consumer protection agencies, administers and enforces the national consumer law, the ACL, which is contained in the *Competition and Consumer Act 2010*.

Medicines and therapeutic goods: The Therapeutic Goods Administration (TGA) regulates all therapeutic goods (medicines, medical devices, blood products and tissues) that are imported into and manufactured in Australia, or exported from Australia.

Electrical equipment: Electrical equipment safety is currently the responsibility of the state and territory governments. Most household appliances are required to be approved by the relevant authority before they can be sold in Australia. The various regulatory authorities have agreed to establish a nationally consistent, performance based electrical equipment safety system and national data base with enforcement to remain the responsibility of the states and territories.

Prohibited and restricted imports: The Australian Customs and Border Protection Service controls the import of specific goods into Australia. These controls are either in the form of a complete prohibition, or for restricted goods, a permit is required to import the goods. Goods on this 'list' include crowd control sprays, laser pointers, chewing tobacco and snuff, pencils and paint brushes with toxic coatings, tablet presses, suicide devices and pornography and objectionable material.

Financial services: The Australian Securities and Investment Commission (ASIC) regulates financial markets, financial service providers, advisers and licences those engaged in providing consumer credit. It has legislative powers to protect consumers against misleading, deceptive and unconscionable conduct in relation to financial services.

Sources: Australian Consumer Law ([www.australianconsumerlaws.gov.au](http://www.australianconsumerlaws.gov.au)), ASIC ([www.asic.gov.au](http://www.asic.gov.au)), Electrical Regulatory Authorities Council ([www.erac.gov.au](http://www.erac.gov.au)), Australian Customs and Border Protection Service ([www.customs.gov.au](http://www.customs.gov.au)).

## **Enforcing product safety**

Australia's consumer protection agencies undertake coordinated biannual national product safety surveillance programs, which include those products sold by web-based suppliers. This enables the ACCC, in conjunction with state and territory consumer protection agencies, to target certain products to assess their compliance with mandatory standards.

A 'product safety hazard assessment clearinghouse' has also been developed by the ACCC for early identification of emerging safety hazards. The clearinghouse shares information and intelligence with state and territory consumer protection agencies

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and overseas agencies and responds when a safety issue has been identified (SCOCA 2011). The ACCC also purchases random samples of products from online suppliers, with those products assessed by independent test laboratories against mandatory performance requirements (ACCC, pers. comm., 30 June 2011).

In recent years, the ACCC has recalled a number of unsafe or dangerous babies' and young children's toys that were being sold over the internet. It has also taken legal action against online traders in regard to product safety breaches (box 5.4). In addition, the ACCC works with the Australian Customs and Border Protection Services in relation to goods listed as being prohibited or restricted goods.

#### **Box 5.4 ACCC action on the safety of online purchases**

In recent years, the ACCC has brought action against online retailers in relation to aspects of the safety of a number of products purchased online.

- In October 2007, the online retailer Overstockoutlet recalled its *Freestyle* 51cm steel frame bicycle and offered court enforceable undertakings, following ACCC investigations which revealed that the bicycle did not meet product safety standards.
- In August 2009, child care restraints supplied by Doreen 3058 via eBay Australia were recalled, following safety concerns raised by the ACCC.
- In January 2011, following a criminal prosecution instituted by the ACCC in the Federal Court, online trader Philip Robinson was convicted and ordered to pay nearly \$15 000 in fines and costs for selling non-compliant infant sleeping bags known as Grobags, without the fire hazard information labels required by the mandatory standards for children's nightwear. These bags were imported from China and sold via the defendant's eBay account and eBay store.

*Sources:* ACCC (2007b, 2009a, 2011f); ACCC v Robinson [2011] FCA 17 (17 January 2011).

However, as noted above, both the ACCC and the state and territory consumer protection agencies make it clear that obtaining consumer redress with respect to purchases by individuals from overseas websites is difficult. Consequently, there has been a focus on monitoring overseas developments in product safety and undertaking surveillance activities as well as educating consumers about online shopping.

#### *The role of monitoring*

To monitor overseas developments on product safety, the ACCC uses its 'clearinghouse' system on product safety intelligence, with data sources that include hospitals, other product safety regulators and international recalls' databases. Product safety is a key focus of the ACCC's international cooperation activities,

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which include a Memorandum of Understanding signed in January 2011 with the United States Consumer Product Safety Commission (ACCC 2011j).

In regard to therapeutic goods, the Therapeutic Goods Administration (TGA) regularly conducts surveillance activities, including laboratory analysis, to monitor compliance levels with mandatory quality standards. Where the TGA becomes aware that Australian consumers may have purchased potentially dangerous therapeutic goods from overseas sources via mail-order or the internet, it issues a safety alert via its website advising consumers to cease using the goods and to consult a health care practitioner if there are any health concerns (Department of Health and Ageing, pers. comm., 19 July 2011).

Since January 2011, the TGA has issued 15 safety alerts in relation to medicines that have been, or may have been, purchased over the internet. In most cases, the TGA's concern has been that the medicines contained prescription-only substances and may be harmful if taken without the supervision of a medical professional,<sup>1</sup> though in some cases it was because the medicines contained substances no longer approved for supply in Australia because of safety concerns (TGA 2011c).

### *Consumer education*

The ACCC provides information to improve consumers' understanding of their rights and how to protect themselves when purchasing online either from local or overseas sites. This includes information to consumers that goods purchased overseas may not meet Australian safety standards and the extent of their rights and arrangements for redress. The ACCC also provides warnings in relation to scam activities and advice to protect against fraud (ACCC 2011g). State and territory consumer protection agencies also provide similar advice to consumers in relation to online shopping.

In recognition of the consumer's right to choose appropriate therapies for themselves, it is possible for individuals to import therapeutic goods into Australia for their own personal use (box 5.5). Such importation is subject to various conditions, and as the TGA advises, it is the responsibility of individuals wishing to import unapproved therapeutic goods for their own use to ensure they have complied with all relevant laws of Australian governments (TGA 2004). It advises:

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<sup>1</sup> To purchase prescription medicines in Australia or from overseas, the purchaser must have a valid Australian-issued prescription. By attempting to purchase a prescription medicine without a prescription, for example from an offshore online supplier, the risk mitigation strategies offered by the intervention of the prescriber are unavailable to the consumer (Department of Health and Ageing pers. comm., 19 July 2011).

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Do not order medicines, including dietary supplements and herbal preparations, over the Internet unless you know exactly what is in the preparation and you have checked the legal requirements for importation and use in Australia.

Products available on international websites are not regulated by the TGA. If care is not taken, you may inadvertently break the law, waste your money or risk your health. (TGA 2011b)

### **Box 5.5 Obtaining therapeutic goods online**

It is possible to obtain legitimate therapeutic goods that have been entered in the Australian Register of Therapeutic Goods (ARTG) from Australian online providers. Therapeutic goods are also available for purchase from international websites. However, if these products are imported for supply in Australia, they must also be entered in the ARTG unless they are in one of the categories exempted by the therapeutic goods legislation, such as for personal importation for use in the treatment of the importer or a member of the importer's immediate family.

Where products are imported for on-sale, including use within a professional practice, they are required to be appropriately entered on the ARTG by the importer who would be recognised as the sponsor of the product and who would need to meet the appropriate responsibilities of a sponsor as set out in the legislation. There is no assurance that therapeutic goods imported directly from international websites and not entered in the ARTG meet the standards of quality, safety or efficacy prescribed by the therapeutic goods legislation. Potential risks of such medicines and medical devices are that they are fake (counterfeit); are too strong or too weak; contain undisclosed, dangerous ingredients; are past their use-by date; or are contaminated or not manufactured to appropriate standards.

*Source:* Department of Health and Ageing (pers. comm., 22 September 2011).

The retail industry itself is also in a position to play a role in educating consumers. Local retailers can provide information on which products meet Australian Standards and the possible implications of using products that do not meet the standard. For example, there are possible insurance implications, likely breaches of road regulations and ineligibility to compete in certain sanctioned events where cyclists use helmets that do not meet Australian Standards. Bicycle Industries Australia said:

Riding with a helmet that is not approved is like riding without a helmet which, therefore, most insurance clauses, as you know, have a clause that would void the insurance. So riding in a helmet that has not been approved puts you at risk of an injury without insurance at all. Most people aren't aware of that ... (trans., p. 136)

Online markets sites such as eBay have also taken steps to advise consumers when they have been directed to an overseas site and provide links to information on Australian product safety standards and warranties (trans., p. 194). In many cases,

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there is clearly a commercial incentive for domestic retailers to provide such information.

*What should be done?*

Many of the concerns raised in submissions are, of course, not new.<sup>2</sup> Also, the consumer safety problems associated with overseas online purchases are not qualitatively different to those arising when Australians return from overseas bringing non-compliant goods (note the exception for medicines which are subject to declaration on arrival (Customs 2011b)). What is different in relation to online shopping is the potential scale of households purchasing products directly from overseas suppliers which may not meet Australian health and safety standards.

When engaging in online shopping, consumers may recognise that the lower price of a product from an offshore supplier reflects the potential risk that the product may not be of the same standard as a similar domestic product. In such cases, consumers appear to be implicitly willing to ‘trade off’ or self-insure against the potential risk of safety problems or failure of the product against the lower purchase price.

However, the non-compliance of an imported good with Australian standards does not necessarily mean that the product poses additional risk to the consumer. It may comply with an overseas standard that provides equivalent consumer protection, even though this equivalence may not be recognised by the Australian regulator.

It is not clear why certain products require a uniquely Australian standard. Indeed, in many or most cases, there are likely benefits in having Australian Standards reflect appropriate international standards. This is particularly the case where significant additional testing may be required or where specifically designed products have to be produced exclusively for the Australian market. In these cases, business would face significant additional costs (which would be passed on to consumers) and there would need to be compelling benefits to justify this.

The Commission, in a commissioned research report on *Standard Setting and Laboratory Accreditation* (PC 2006), found that, in general, there should be a preference for international standards as they facilitate the importation of a wider range of goods to consumers and ensure Australia fully participates in the global market place. It went on to recommend that while the suitability of such standards

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<sup>2</sup> For example, the Pharmacy Guild’s call for regular checks and monitoring of internet sites selling medicines follows the call last year by the Pharmaceutical Society of Australia (related to concerns about counterfeit medicines) that the TGA test medicines sold online (O’Donoghue 2010).

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should continue to be assessed on a case-by-case basis, Standards Australia should publish the compelling reasons where an Australian Standard departs from an equivalent international standard.

In the case of bike helmets, Standards Australia commented that there were no international standards — standards published by the ISO (International Standards Organization) or IEC (International Electrotechnical Commission) — that were applicable or a single overseas standard that could be considered as a defacto international standard. It was for these reasons, that the Standard relating to bike helmets, AS/NZ 2063, did not contain details of deviations from other overseas standards (Standards Australia, pers. comm., 28 October 2011).

For the regulatory agencies, enforcing product safety standards with respect to purchases by individuals from overseas websites is difficult. Clearly, it would not be cost effective or even practically possible to examine every overseas product purchased online and imported into Australia to ensure compliance with Australian health and safety standards. In 2010-11, nearly 58 million parcels entered Australia as low value international mail and as air cargo consignments (see chapter 7). Consequently, regulators take a risk based approach to monitoring and surveillance of imports using information and intelligence provided by consumers, state and territory regulators and overseas regulators. Information sharing and cooperation with overseas and domestic agencies would appear to be the key in dealing with any consumer safety problems associated with overseas online purchases.

In 2003, Justice Sackville in *ACCC v Chen* noted:

While domestic courts can, to a limited extent, adapt their procedures and remedies to meet the challenges posed by cross-border transactions in the internet age, an effective response requires international co-operation of a high order ... (*ACCC v Chen* [2003] FCA 897 at 61)

In 2008, the Commission noted that:

... as e- and m-commerce continue to develop, it will be necessary to monitor the adequacy of consumer laws to meet emerging issues. Also, the further growth in cross-border transactions will put a premium on effective cooperation between regulatory agencies, both within Australia and with their counterparts overseas. To this end, some new measures may be required — especially to facilitate information sharing and cooperative enforcement activity with other countries. (PC 2008b, vol. 1, p. 53)

Considering developments over the last few years, regulators appear to be conscious of the risk of significant harm and the increased scale of potentially non-compliant consumer imports. As discussed earlier, regulators like the ACCC and the TGA are stepping up monitoring and surveillance activities, including through more extensive cooperation with overseas regulators and increased warnings to

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consumers. In some cases, this increased surveillance has also resulted in enforcement action.

Nevertheless, the potential magnitude of the increase in overseas online shopping raises a question of the future level of such efforts. While regulators appear to be handling these concerns within their current compliance and enforcement frameworks, consideration needs to be given to both the tools available for the most effective overseas cooperation and the scale of the surveillance and monitoring task.

### **Concerns relating to warranties and refunds in overseas online retail**

The ACL provides a basic set of guarantees for consumers who purchase goods and services from Australian suppliers (including Australian-based online sellers, importers and manufacturers) on or after 1 January 2011. These consumer guarantees (for example, that goods are of acceptable quality, fit for purpose, and there is reasonable provision of spare parts and repair facilities) apply regardless of any supplier or manufacturer warranty the consumer is given or purchases.

As these guarantees may not be applicable to goods purchased online from overseas retailers, the issue of warranties and refunds was of concern to a number of participants. Some submissions (Photo Marketing Association, sub. 40; Bicycle Industries Australia Ltd, sub. 53) noted the potentially lesser warranty rights in relation to overseas online purchases. The Fair Imports Alliance (FIA) similarly states:

... many of FIA's members reported that consumers who had purchased goods from offshore sellers were bringing them back to retail stores in order to place warranty claims. This became problematic as certain products only had international warranties which were not recognised in Australia. (sub. 47, p. 16)

This situation can be common, and puts local businesses in a dilemma, according to Bicycle Industries Australia Ltd:

Further impacting on the promotion of individual brands is that Australian bicycle wholesalers ... receive on average 111 product returns per year for products which have been purchased from an offshore retail site and returned to the Australian company for warranty repairs.

The Australian wholesaler is forced to make the decision to service a product it did not sell, or risk the negative publicity relating to their product. (sub. 53, p. 8)

Similar issues can arise where so called grey or parallel imports (genuine goods that are not imported by the licensed distributor) are sold to consumers and they then seek a repair or replacement under express warranties/guarantees as if they were sold by licensed distributors in Australia (ACCC pers. comm., 16 September 2011).

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In some circumstances, Australian distributors, even on a fee for service basis, may choose not to service products, such as hi fi equipment, purchased overseas to create a deterrent to consumers purchasing online from overseas retailers (Alex Encel, sub. DR209).

Bicycle Industries Australia Ltd also recognised that the consumer's right to a refund in accordance with the ACL may not extend to overseas purchases (sub. 53). Although this is made clear by the ACCC (ACCC 2011d) in its advice to consumers, some retailers such as the Retail Trader's Association of Western Australia (sub. 80) considered that consumers required more detailed information in this regard.

### *What should be done?*

The diversification of retail activity across different channels in Australia and overseas adds complexity to consumer rights to redress and the processes for securing such redress. Continued consumer education is likely to be necessary to ensure that consumers remain sufficiently aware of these rights and processes. Although consumer education is primarily a role for consumer protection agencies, there are commercial incentives for local retailers to assist in filling any 'information gaps' facing consumers about their warranty rights and ability to seek refunds when purchasing goods online from overseas traders.

Consumers have to weigh up the risk that the lower priced product purchased online from an offshore supplier may not be subject to the same warranties and rights to refunds or service as the higher priced domestic product. In effect, by purchasing the lower priced product online from an offshore supplier, consumers have opted to 'self insure' against the potential risk of product failure or defects.

Nevertheless, overseas online retailers may not necessarily provide lesser access to refunds and warranties than domestic retailers. Like local retailers, they face commercial incentives, along with the consumer protection requirements in their country of origin, to provide for refunds, returns and warranties on the products they sell. However, there may be issues of time and convenience for consumers in accessing such redress from overseas retailers.

There may also be an opportunity for the market to respond with services that have not existed previously — such as a business model which provides advice and support to those who have purchased online for a fee or through a new form of warranty.

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## **5.3 Online transaction security and protection against fraud**

Online shopping, including via online auctions, involves the risk that customers can become the victims of online fraud where goods fail to turn up or do not meet the customer's expectations, or where products offered for sale are used as inducement for internet scammers to unlawfully retrieve credit card or bank account details. Fraudulent use of data can also be the result of breaches of database security and may involve the risk of theft of personal identity as well as savings.

### **Internet scams**

In 2009-10, the number of scams reported to the ACCC rose to over 22 000, more than double the number in the previous year. Scams comprised over half of all complaints to the ACCC in 2009-10. (ACCC, pers. comm., 10 June 2011). While scams involving online auction and shopping are one of the most common types, many do not involve financial loss and in most cases the losses are not substantial (box 5.6).

### **Current concerns about online transaction security**

Concerns about online transaction security are one of the most significant factors in discouraging some people from shopping online. Recent surveys have found that around a quarter of people do not shop online because of concerns about security and that 12 per cent of people do not shop online because they do not want to provide their credit card details online (ACMA 2010a; Irvine et al. 2011). A survey by the United Kingdom Office of Fair Trading found that 17 per cent of people who use the internet would not shop online due to worries about security of personal information (Office of Fair Trading UK 2007).

However, there are indications that online consumers' own behaviour may be contributing to the risk. A 2011 survey by PayPal found that consumers were not only storing personal information on social networking sites, but were also sharing their personal information on sites such as online shopping sites, recruitment services and real estate websites. Despite three quarters of respondents being concerned about the information they shared online, the survey found that:

- almost half of respondents did not know how many sites held their personal details
- nearly 60 per cent admitted using the same password across multiple accounts.

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These practices were assessed as increasing the risk of theft of savings and also of personal identities (PayPal 2011b).

#### **Box 5.6 Online shopping scam activity in 2010**

Scams related to online auction and shopping have increased in recent years.

- In 2010, a total of 5527 complaints about such scams were made, up from around 3400 reported in 2009, and around 1700 reported in 2008:
  - these scams typically involve purchase of products advertised on popular online auction websites where the product never arrives or is inferior to the product promised
  - while around 34 per cent of the complaints involved loss of money, in total around \$4 million, almost all consumers suffered losses valued at less than \$10 000, with the average loss being around \$2000 in 2010
  - around one-third of reported scams in 2010 originated through telephone calls, and reports indicate that calls may have originated from overseas call centres, likely taking advantage of cheap or free voice-over-internet services.
- In addition to scams involving online auction and shopping, a proportion of the 14 739 scams involving advance fee or up-front payments were reported by consumers either buying or selling online.

Sources: ACCC (2010c, 2011i).

#### *Mandatory notification*

Recent high profile security breaches have led to renewed calls for a mandatory notification obligation, previously recommended by the Australian Law Reform Commission (2008). Under this approach (and subject to the detail), an organisation that holds personal information and is then made aware (or reasonably suspects) that this information has been obtained by an unauthorised person would be required to notify the affected person in a timely manner (Choice, sub. 82). However, while mandatory notification is seen as increasing private incentives to secure databases adequately, overseas experience in this regard is not conclusive (Winn 2009). Furthermore, in the event of a breach, consumer detriment would only be reduced to the extent that consumers can practically use the notification to minimise harm.

#### *Improving security in online shopping*

Future developments in technology and its use will influence the type of risks associated with online retailing. A current example is the move towards mobile

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commerce through the use of mobile phones and similar devices. In general, regulation to address problems of consumer protection related to particular technologies or their use is likely to be quickly outdated.

There have been various market responses to address such risks. In response to the strong demand for secure online payment services by online consumers, Australian credit card issuers offer a charge-back or guaranteed refund of fraudulent credit card transactions. In addition, other e-commerce businesses such as PayPal provide buyer protection policies covering cases where the good does not arrive or is significantly different from its description. Such policies implemented by online service providers help protect eligible shoppers on merchant websites and so generate consumer confidence in online shopping (PayPal 2011c).

Future online transaction security and protection against fraud is likely to continue to rely on a combination of market responses to new problems as they emerge, a prudent approach by consumers in the use of their personal and financial data and regulation that provides benefits commensurate with costs.

## 5.4 Search engines

The role and quality of search engines is of broad interest to consumers, given their role in advertising and enabling consumers to research product offerings and compare prices. The algorithm by which search engines rank websites is a proprietary matter for each company, and each is likely to produce different results for the same query. The example below illustrates this — three search engines gave 11 different addresses in their top five results for a single search (table 5.1). This diversity of results may offer consumers a service provided they are aware that such diversity exists, and that other items on search results pages — specifically ads and sponsored links — are chosen and ranked on a different basis.

Several submissions to this inquiry have raised concerns about potential bias in search engines and the potential impact on competition. The Initiative for a Competitive Online Marketplace (ICOMP) commented on the implications of the increasing importance for businesses of search engines to access consumers:

... where there is a single dominant search engine the current framework in the digital economy requires scrutiny, especially given the dependency of so many businesses on the services of a single search provider and online advertising network. (sub. 42, p. 10)

**Table 5.1 Top five web addresses for “top selling 3D TV Australia” using Google, Yahoo and Bing, by order, 10 June 2011<sup>a</sup>**

<i>Top ten web addresses</i>	<i>Google</i>	<i>Yahoo</i>	<i>Bing</i>
<a href="http://www.smarthouse.com.au/TVs_And_Large_Display/3D_TV">www.smarthouse.com.au/TVs_And_Large_Display/3D_TV</a>	1	1	1
<a href="http://www.browndwhite.com.au/brown-goods/tvs.html">www.browndwhite.com.au/brown-goods/tvs.html</a>	2		
<a href="http://www.arnnet.com.au/article/342716/samsung_launches_3d_tv_australia/">www.arnnet.com.au/article/342716/samsung_launches_3d_tv_australia/</a>		2	2
<a href="http://www.gizmodo.com.au/2010/03/the-best-3dtv-samsung-un55c7000-vs-panasonic-tc-p50vt20/">www.gizmodo.com.au/2010/03/the-best-3dtv-samsung-un55c7000-vs-panasonic-tc-p50vt20/</a>	3		
<a href="http://www.lcdtvbuyingguide.com/top10.shtml">www.lcdtvbuyingguide.com/top10.shtml</a>		3	3
<a href="http://www.3dtvchoices.com.au/">www.3dtvchoices.com.au/</a>	4		
<a href="http://www.getprice.com.au/3d-led-tv-televitions.htm">www.getprice.com.au/3d-led-tv-televitions.htm</a>		4	
<a href="http://en.wikipedia.org/wiki/3D_television">en.wikipedia.org/wiki/3D_television</a>			4
<a href="http://www.dtvforum.info/lofiversion/index.php?t89597.html">www.dtvforum.info/lofiversion/index.php?t89597.html</a>	5		
<a href="http://www.getprice.com.au/televitions.htm">www.getprice.com.au/televitions.htm</a>		5	
<a href="http://www.thinktv.com.au/content_common/pg-3d-tv.seo">www.thinktv.com.au/content_common/pg-3d-tv.seo</a>			5

*Source:* PC research (2011).

<sup>a</sup> The 11 results are an upper bound on the diversity of information, as some addresses are specific sections of others, such as those for [www.getprice.com.au](http://www.getprice.com.au).

The Council of Small Business Organisations of Australia (COSBOA) expressed its concern as follows:

... that as the internet takes over ... the big search engines and the big retailers will join forces to ensure that only their sites can be found. (sub. 74, p. 5)

In its submission in response to the draft report, ICOMP expressed concerns about the potential impact on advertising rates of a dominant search engine and pointed to the potential benefits from greater competition in this area:

If the rates for paid search were reduced, Australian businesses are likely to be in a better position to direct their profits towards internal business growth and diversification, research and development and other initiatives which could benefit their consumer base and overall, strengthen Australian’s retail industry. (sub. DR215, pp. 1-2)

These follow previous concerns and claims that search engines have ‘downgraded’ the results of other search providers and used search results to promote their own services. Some have suggested that a principle of ‘search neutrality’ be applied in regard to online search. Under such a principle, search engines would treat all web pages, including those with commercial links, without discrimination to produce comprehensive search results based on the most relevant results (Fear and Dennis 2011; Search Neutrality 2010).

Regulators both within Australia and overseas have taken action in response to such concerns.

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In 2007, the ACCC announced that:

... [it] has instituted legal proceedings in the Federal Court, Sydney, against Trading Post Australia Pty Ltd, Google Inc, Google Ireland Limited and Google Australia Pty Ltd alleging misleading and deceptive conduct in relation to sponsored links that appeared on the Google website.

The ACCC is alleging that Trading Post contravened sections 52 and 53(d) of the *Trade Practices Act 1974* in 2005 when the business names “Kloster Ford” and “Charlestown Toyota” appeared in the title of Google sponsored links to Trading Post's website.

Kloster Ford and Charlestown Toyota are Newcastle car dealerships who compete against Trading Post in automotive sales.

The ACCC is also alleging that Google, by causing the Kloster Ford and Charlestown Toyota links to be published on its website, engaged in misleading and deceptive conduct in breach of section 52 of the Act.

Further, the ACCC is alleging that Google, by failing to adequately distinguish sponsored links from “organic” search results, has engaged and continues to engage in misleading and deceptive conduct in breach of section 52 of the Act. (ACCC 2007a)

Further background was provided in the undertaking given to the ACCC by Trading Post Australia:

In or about August 2005, Trading Post’s agent, contrary to Trading Post’s instructions, purchased “Kloster Ford” and “Charlestown Toyota” as keywords to be used in the title or headline of Trading Post’s Search Engine Advertising on the Google search engine. “Kloster Ford” and “Charlestown Toyota” are the registered names of car dealerships located in New South Wales.

The result was that, when “Kloster Ford” or “Charlestown Toyota” was entered into the Google search engine as a search term, the Search Engine Advertisement which was returned and which was located at the top left hand side of the results page (i.e. immediately before the “organic” search results) reproduced the names “Kloster Ford” and “Charlestown Toyota” in the title or headline. When the user clicked on the title or headline of the Search Engine Advertisement they were taken to the Trading Post Website. (ACCC 2008e)

In its judgement handed down in September 2011, the Federal Court dismissed the allegations that Google had engaged in misleading and deceptive conduct. The Court found that, ‘most users would have appreciated that “sponsored links” were in fact advertisements’. Further, the Federal Court found that Trading Post had, ‘made false or misleading representations and engaged in misleading or deceptive conduct’ (ACCC 2011c, p. 1). This followed the admission by the Trading Post in April 2008 that its conduct had breached section 52 and section 53(d) of the Act (ACCC 2008e).

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The ACCC in October 2011 filed an appeal against the decision of the Federal Court in relation to the advertisements appearing on Google's website (ACCC 2011b).

Internationally, in November 2010, the European Commission issued a statement of initiation of proceedings in response to formal complaints:

The European Commission has decided to open an antitrust investigation into allegations that Google Inc. has abused a dominant position in online search, in violation of European Union rules (Article 102 TFEU). The opening of formal proceedings follows complaints by search service providers about unfavourable treatment of their services in Google's unpaid and sponsored search results coupled with an alleged preferential placement of Google's own services. This initiation of proceedings does not imply that the Commission has proof of any infringements. It only signifies that the Commission will conduct an in-depth investigation of the case as a matter of priority. (EUROPA 2010)

The U.S. Federal Trade Commission (FTC) has also commenced investigations into certain business practices used by Google:

On June 23, 2011, Google Inc. received a subpoena and a notice of civil investigative demand from the U.S. Federal Trade Commission (FTC) relating to a review by the FTC of Google's business practices, including search and advertising. Google is cooperating with the FTC in this investigation. (U.S. SEC 2011)

In its response to the draft report, Google recognised that, as its business has grown, its business practices and principles have been subjected to greater scrutiny. Google was of the view that it was able to provide what consumers wanted through product innovation and engineering, 'in a world where the competition is just a click away' (DR199, p. 7). In regard to ranking its own content Google said:

For content like images or news, it's not actually Google's content, but rather snippets and links to content offered by publishers. We are merely grouping particular types of content together to make things easier for users. In other cases, we might show a Google Map for a search for an address. But our users expect that, and search results will also include competing map services. ...

Ultimately, if we messed with results in a way that did not serve our users' interests, they would and should simply go elsewhere - not just to other search engines like Bing, but to specialized sites like Amazon, eBay or dealsdirect.com.au. (DR199, p. 8)

The market conduct of search engine providers is a critical issue for online e-commerce to ensure that the provision of information to consumers, one of the key advantages of internet shopping, is not compromised. Accordingly, where there is evidence of possible anti-competitive behaviour, regulators both in Australia and overseas are investigating this matter.

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## **Conclusion**

While consumers are becoming increasingly confident about online shopping, the dynamism of the market and the demands of more numerous and complex transactions will require a keener awareness by consumers than in the past. Considerations of ‘buyer beware’ become more important when shopping online. Online service providers and traders have responded to consumer demands to improve online security and there appears to be further opportunities for the market to respond with services that have not existed previously to address other consumer assistance issues associated with online shopping.

Over time, regulators too may be required to work differently as well as devote more resources to addressing risks related to online purchases and product safety. International cooperation and agreements with overseas regulators will become more important in this area with the projected growth in overseas online retailing. Otherwise, the current regulatory arrangements may not keep pace with the rapidly globalising marketplace.



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## 6 Retail price differences

### Key points

- Price is an important factor for many Australians in choosing where to shop. Currently many consumers enjoy cheaper prices across a broad range of goods when shopping online.
- The Commission conducted its own snapshot price comparisons of a select range of products. The majority of products had lower prices in online retail stores (predominantly from international online retailers), with the price differential with Australian bricks and mortar stores 50 per cent or more in some product categories. However, simple retail price comparisons require some caveats as a reflection of consumers' willingness to make a purchase (as they overlook several non-price considerations).
- Price differences across retailers and retailer-types are not unexpected and there are some key cost drivers that can contribute to this, including wage and other labour costs; rent and other occupancy costs; wholesale and distribution costs; and other retailer-specific costs. Government taxes and profit margins can also be significant influences on price differences.
- International effects such as exchange rate changes and regional pricing strategies of international suppliers are also contributing factors in retail price differences. The latter is becoming increasingly visible to consumers as the internet informs consumers of the practice and more opportunities for consumers and retailers to purchase and source products overseas become available.
- The parallel importation of goods represents an alternate supply channel in which legitimately produced goods can be imported into a country. The parallel importing and selling of most goods in Australia is a legal practice, though it may give rise to warranty issues or differences in product specifications. Copyright restrictions on some clothing goods can allow copyright owners to prevent parallel imported goods being resold and thereby limit competition. An examination of the costs and benefits to the Australian community of maintaining regulations which restrict the resale of parallel imported goods should be undertaken.
- Consumers will typically search out the best price and conditions for a purchase — irrespective of whether it is from a bricks and mortar or online retailer — given their individual preferences. The growth of online shopping will increase the competitive pressure on retailers to meet consumer preferences through offering either lower prices, improved service, better overall 'shopping experiences' or a combination of these factors.

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While convenience and a wider range of available goods are significant factors attracting consumers to shop online, the price of goods is arguably the most important factor for many Australians. The Commission received several submissions and examples highlighting the considerable price advantage of making purchases online and the existence of significant price differences between goods bought locally in traditional bricks and mortar stores and identical products bought from online retailers — both local and overseas (box 6.1).

### **Box 6.1 Participants' views on the cheaper online alternative**

#### **USA Shopping Affair:**

Even with an additional 10% GST charged on imported goods, consumer behaviour would unlikely change as many products will continue to be significantly cheaper to purchase online from overseas retailers. (sub. 16, p. 1)

#### **Gerry Affat:**

For the items I can purchase locally, these are often 2 to 3 times the price of the overseas sites. So even with postage and GST I am still ahead. (sub. 12, p. 1)

#### **Bradley Mortimer:**

The particular shoes that I buy ... can be bought in a number of sports shops in my local area and cost \$220.00 in every shop. Over the last few years, I have been purchasing the same shoes online through United States based online retailers. The last pair of shoes cost me A\$109.00, delivered to my door ... for my shoes to be less than half the price (even after air freight shipping to my door) it begs the question as to who is making that significant margin in respect of domestic sales of those shoes to Australian consumers. (sub. 3, p. 1)

#### **Derek E. Elwell (residing in the United Kingdom):**

Australians are effectively paying far more in their own country for a 100% home-grown product than we overseas purchasers have to pay, despite any additional costs such as shipping and distribution within the UK. (sub. 15, p. 2)

#### **Gregory Hibbett:**

It is widely and frustratingly understood by adult gamers in Australia we are grossly discriminated against when it comes to retail prices on video games (as well as other retail product) ... My personal level of frustration grew even further as the Australian dollar reached parity with the United States dollar and prices here only climbed. *Still* we are being told to pay more than double in retail stores. (sub. 116, p. 1)

#### **Leon Geisler:**

... Not wishing to pay the Australian price, I asked an American friend of mine to order the [equipment from Amazon] and send it to me here in Sydney, and I paid him back ... saving me \$80 ... enforced price differentials, especially for online downloads, are baseless and exploitative of the average Australian consumer, who will not complain about the price for the sake of convenience and minimal hassle. (sub. DR238, p. 1)

Several media articles and a number of studies have similarly drawn attention to retail price disparities and a prevailing question of why bricks and mortar retailers

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in Australia cannot compete on price with domestic and international online (Griffith 2011; Keane 2011; Irvine et al. 2011). Some specific price comparisons of goods have also been made to highlight these discrepancies:

The same LG refrigerator costing \$2500 at Harvey Norman – billionaire Gerry Harvey was the initial face of the retailers’ campaign against the internet – is available to American consumers from Amazon for just under US\$1500. (Keane 2011, p. 1)

On the other hand, Alex Encel noted the misinformation on overseas price differentials often quoted in the media:

It is easy to find examples of where prices are cheaper on the Internet overseas ... It is also easy to find prices that are similar or even less in Australia than overseas. But this does not fit in with the consistent retailer bashing that is found in the general media. Retailers vary a lot but their consistent portrayal as behind the times, stupid and greedy in comparison to overseas Internet purchasing is prejudiced and unfair. (sub. DR209, p. 1)

The existence of price differences for identical goods is not an uncommon or new phenomenon in the world of retailing. This chapter will address the issue of retail price differences in terms of three broad contributing factors for retailers:

- cost structures
- profit margins
- international effects.

## **6.1 The Commission’s retail price comparisons**

The Commission conducted its own illustrative price comparisons of identical retail goods to determine whether significant differences exist between retailers and retailer-types. A concise version is presented in table 6.1, while the full list of 40 goods is provided in appendix E.

The Commission’s comparisons are from an Australian consumer’s perspective. Therefore, prices were considered for a selection of Australian bricks and mortar (or multi-channel) retailers, Australian online retailers (including shipping and delivery costs) and overseas online retailers (including shipping and delivery costs) for identical goods. Further, these price comparisons constitute a ‘snapshot’ of prices at a point in time, and do not account for further discounts or sales that are offered periodically or individually negotiated.

The comparisons show that for the majority of goods examined, the cheapest price offerings were from online retailers rather than from Australian bricks and mortar stores (even after accounting for the shipping and delivery fees), with the majority

of the lowest prices from international online retailers. Of the five product categories chosen, some had more consistently lower prices online and/or abroad than others. All goods (except for one) in the books, DVDs and music category had the cheapest price offering from international online retailers, with the price differential being 50 per cent or more compared with some Australian bricks and mortar stores. On the other hand, the computer and electronics category was mixed, with some Australian bricks and mortar retailers offering the cheapest prices (some even before accounting for shipping and postage costs).

**Table 6.1 Price comparisons of identical goods — an Australian consumer's perspective**

In Australian dollars

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>		<i>Australian online</i>			<i>International online</i>			
<b>Computer and electronics</b>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>			
<b>Canon IXUS 105IS digital camera</b>	176.00	169.95	185.00	188.00	218.90	124.00			
Shipping/delivery <sup>c</sup>	na	na	9.90	35.30	14.95	64.00			
<b>Total</b>	<b>176.00</b>	<b>169.95</b>	<b>194.90</b>	<b>223.30</b>	<b>233.85</b>	<b>188.00</b>			
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>		
<b>Sony Handycam DCR SR68</b>	448.00	436.00	453.75	488.57	491.31	276.00	367.00		
Shipping/delivery	na	na	9.90	10.00	12.00	86.36	0		
<b>Total</b>	<b>448.00</b>	<b>436.00</b>	<b>463.65</b>	<b>498.57</b>	<b>503.31</b>	<b>362.36</b>	<b>367.00</b>		
<b>Toys and games</b>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Monopoly Revolution Board Game</b>	69.95	80.00		59.95	59.95	56.16	23.45	21.08	41.69
Shipping/delivery	na	na		4.95	13.95	0	26.95	38.43	9.19
<b>Total</b>	<b>69.95</b>	<b>80.00</b>		<b>64.90</b>	<b>73.90</b>	<b>56.16</b>	<b>50.40</b>	<b>59.51</b>	<b>50.88</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	
<b>L.A. Noire game (PlayStation 3)</b>	88.00	88.00	104.99	77.68	56.25	56.50	61.45	38.99	
Shipping/delivery	na	na	na	0	8.95	8.90	2.99	9.99	
<b>Total</b>	<b>88.00</b>	<b>88.00</b>	<b>104.99</b>	<b>77.68</b>	<b>65.20</b>	<b>65.40</b>	<b>64.44</b>	<b>48.98</b>	
<b>Health and Beauty</b>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Britney Spears Circus Fantasy 100ml</b>	49.95	67.15	79.00	39.90	39.95	48.5	48.00	33.91	42.39
Shipping/delivery	na	na	na	9.95	7.95	4.95	0	15.37	8.48
<b>Total</b>	<b>49.95</b>	<b>67.15</b>	<b>79.00</b>	<b>49.85</b>	<b>47.90</b>	<b>53.45</b>	<b>48.00</b>	<b>49.28</b>	<b>50.87</b>

(continued on next page)

Table 6.1 (continued)

<i>Product</i> <sup>a</sup>	<i>Australian bricks and mortar</i> <sup>b</sup>			<i>Australian online</i>			<i>International online</i>		
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>		<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Lancôme Hypnose Spray 50ml</b>	116.95	88.40	130.00	73.00	66.00		66.00	52.70	53.75
Shipping/delivery <sup>c</sup>	na	na	na	0	0		0	14.84	22.51
<b>Total</b>	<b>116.95</b>	<b>88.40</b>	<b>130.00</b>	<b>73.00</b>	<b>66.00</b>		<b>66.00</b>	<b>67.54</b>	<b>76.26</b>
<i>Books, DVDs and Music</i>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Australians: Origins to Eureka (hardcover)</b>	59.95	59.99	59.99	34.45	42.35	44.35	21.68	33.93	25.88
Shipping/delivery	na	na	na	0	7.00	6.50	8.43	0	8.86
<b>Total</b>	<b>59.95</b>	<b>59.99</b>	<b>59.99</b>	<b>34.45</b>	<b>49.35</b>	<b>50.85</b>	<b>30.11</b>	<b>33.93</b>	<b>34.74</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>		<i>C1</i>	<i>C2</i>	
<b>Born This Way: Lady Gaga album</b>	17.99	21.99	19.99	21.45	19.90		13.95	11.19	
Shipping/delivery	na	na	na	0	2.00		0	8.99	
<b>Total</b>	<b>17.99</b>	<b>21.99</b>	<b>19.99</b>	<b>21.45</b>	<b>21.90</b>		<b>13.95</b>	<b>20.18</b>	
<i>Outdoor and apparel</i>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>			<i>C1</i>		
<b>Spalding NBA Never Flat Basketball</b>	74.99	74.99		70.00			87.57		
Shipping/delivery	na	na		8.50			7.81		
<b>Total</b>	<b>74.99</b>	<b>74.99</b>		<b>78.50</b>			<b>95.38</b>		
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>				<i>C1</i>	<i>C2</i>	
<b>NIKE Dri-Fit Feather Light Hat</b>	29.99	30.00	30.00				26.30	18.78	
Shipping/delivery	na	na	na				12.11	28.89	
<b>Total</b>	<b>29.99</b>	<b>30.00</b>	<b>30.00</b>				<b>38.41</b>	<b>47.67</b>	

<sup>a</sup> Prices of the identical good from multiple retailers were collected within the same one or two day period.

<sup>b</sup> Where the retailer is a multi-channel retailer, the price on the online catalogue is assumed to be the same as the price of the good in the bricks and mortar store. <sup>c</sup> All delivery charges are based on the cheapest delivery option available. Prices do not take into account discounts or reductions in shipping costs which may accompany multiple purchases of goods.

Source: PC research (2011).

Indeed, while the internet has reduced search costs significantly, the dispersion in online retail prices demonstrates that there is little convergence to a single price for identical goods and the ‘Law of One Price’.<sup>1</sup> Even when shipping and postage costs are taken into account, online prices for identical goods are not uniform, with

<sup>1</sup> The Law of One Price states that in efficient markets, the prices of identical goods sold by multiple sellers will converge as buyers have perfect information about the market and minimal transaction and search costs. Given the advent of online shopping and the internet, which has increased the transparency of prices for consumers significantly, the move towards price convergence and the Law of One Price — at least in theory — should occur.

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consumers still having to expend time finding a ‘good deal’ (for example, some online retailers even sell the same product on their website at a price which is different from what they offer on other sites such as eBay or Amazon). Baye, Morgan and Scholten (2002) attributed the maintenance of online price dispersion to retailer-specific factors such as brand loyalty, trust and security, and product availability. The extent to which consumers have full information about price differences would also be a factor — some would not be aware of cheaper prices and would not spend as much time searching. Similarly, these factors affect the extent of price differences among retailers more broadly.

### **Caveats on price comparisons**

Comparing the prices of the same product requires some qualifications. Table 6.1 consists of randomly chosen products to the extent that price comparisons could be made and that overseas retailers were able to ship the goods to Australia.

Further, while it is easy to make conclusions that the price of the good is significantly cheaper from one retailer-type to another, there are many aspects of the product and retailer-specific considerations that are valued by consumers that have not been captured by price alone (box 6.2). More details about the Commission’s price comparisons are provided in appendix E. Therefore, while price comparisons allow for a quick illumination of differences which may exist, such comparisons may not be fully reflective of consumers’ willingness to make a purchase.

## **6.2 Factors influencing retail prices**

Price differences across retailers and retailer-types are not unexpected and there are many factors that can contribute to them. While it is impossible to fully explain all reasons for differences in prices across retail goods, generally, the cost structure of different types of retailers, profit margins, and international effects are the key explanatory factors.

### **Gross margins and mark ups**

There are many elements that constitute the cost of a good by the time it reaches the shelves (actual or virtual) on offer to consumers: from its place of manufacture and origin; to the wholesaler; to the distributor; to the retailer; and finally to the consumer. A good can flow through several distribution points which affect its final cost, with costs and profits factored in at each of these distribution points. Therefore, the retail price of a good is composed of the initial manufacture cost (or

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the 'landed cost' if imported) and the gross margins of the wholesaler and/or retailer.

### **Box 6.2 Caution about retail price comparisons**

'Snapshot' comparisons of product prices do not reflect:

- the time it takes for the consumer to receive the product. While consumers in bricks and mortar retailers will typically take the product home at the time of transaction, online purchases can sometimes take up to several days or weeks to reach the consumer (although these times can vary considerably among online retailers)
- the potential for consumers to negotiate final prices in-store, often using online retailers' prices as leverage. In contrast, the online prices for products are generally non-negotiable
- the level of after-sales service available on the product. Purchases from overseas may not have an Australian or international warranty, which usually means that consumers would have to send the product back to the retailer abroad (often needing to pay for postage costs) if anything is faulty. Though less costly, some domestic online retailers may have similar conditions, however in these cases the consumer is covered by Australian consumer law (chapter 5)
- compatibility in Australia. While many overseas online retailers sell products to Australians, some (particularly electronic goods) may need additional connectors or plugs to make them operational here. Further, subsequent add-ons may or may not be compatible with overseas products. For example, some computer games from other countries may not be compatible with Australian expansion packs or supplements (and would require time and possibly other purchases to sidestep this restriction)
- the extent of close substitutes for products.

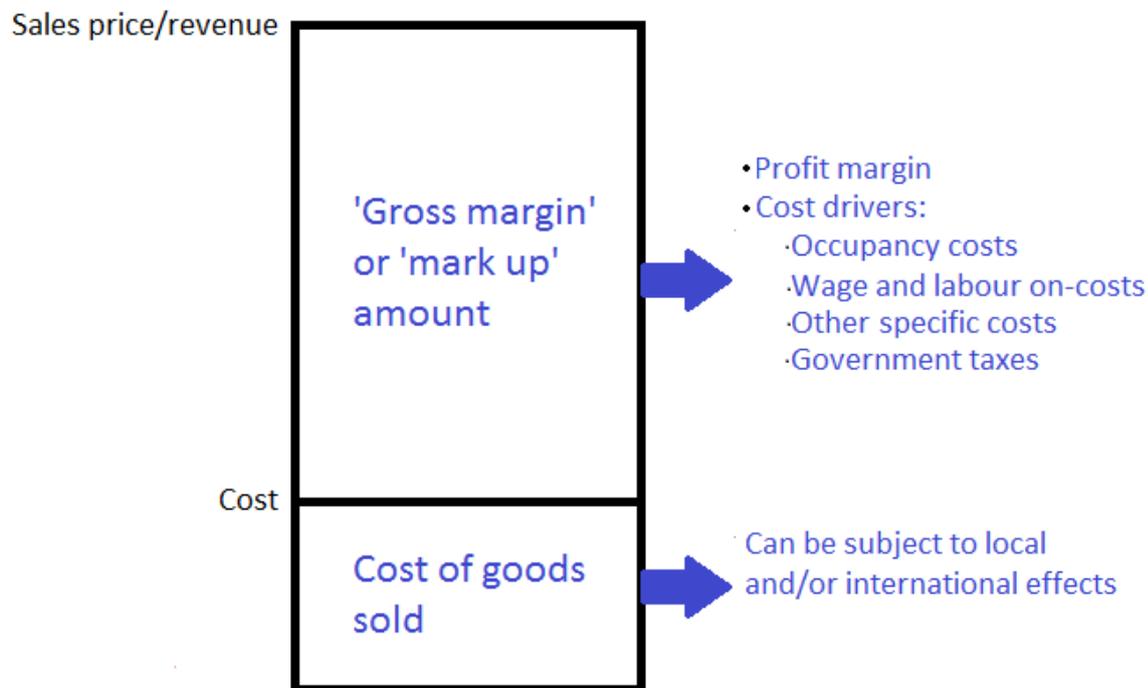
Therefore, there are many price and non-price aspects which are not factored into 'snapshot' comparisons, and the weight that consumers place on these aspects (such as time, service, flexibility) vary from one shopper to the other.

The 'gross margin' or 'mark up' of a good refers to the difference between its cost (cost of goods sold) and its selling (or reselling) price. It accounts for a number of factors including overhead and operating costs and profit margins, and can be applied at different stages in the distribution process (for example, at wholesaler or retailer level).

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Figure 6.1 **Gross margin and mark up on costs**

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Figure 6.1 shows the pricing composition of a product. For a wholesaler, the cost of goods sold is the purchase cost (or landed cost) and for retailers, the cost of goods sold is the wholesale cost. The difference between the cost and the sales price is the gross margin or mark up amount.

While the terms 'gross margin' and 'mark up' are sometimes used interchangeably, there is a distinction between the two in relation to percentages. In absolute amounts, the gross margin and mark up of a good are identical. For example, if Product A has a wholesale cost of \$100 and the retail sales price is \$200, the retailer gross margin and retailer mark up *amount* is \$100. However, expressed as percentages, the gross margin is based on retailer sales price, while mark up is based on the retailer cost price or cost of goods sold. Therefore Product A has:

- 100 per cent retailer mark up (based on wholesale cost:  $\$100/\$100 = 1$ )
- 50 per cent retailer gross margin (based on sales price:  $\$100/\$200 = 0.5$ ).

Therefore, the percentage mark up is the percentage of the cost price added to get the selling price, while the percentage gross margin is the percentage of the final selling price that is gross profit (excluding overheads).<sup>2</sup>

Most estimates, for example those used by the ABS and other international data agencies, calculate wholesale and retail margins based on sales price. National data on wholesale and retail margins are presented in table 6.2 for Australia, the United States and Canada. In aggregate, while categories of goods differ, the gross margins of the wholesale industry in 2006 *expressed as a percentage of wholesale sales* were broadly similar for Australia and the United States, but lower in Canada. Further along the supply chain, gross retail margins for Australian retail *expressed as a percentage of retail sales* were similar to the gross retail margins in the United States and Canada.

**Table 6.2 International comparison of gross margins, 2006**

	<i>Wholesale</i>	<i>Retail</i>
Australia	20.3%	25.7%
United States	19.1%	27.8%
Canada	15.0%	25.0%

Sources: ABS (2007b); Industry Canada (2009); U.S. Census Bureau (2009).

However, it should be noted that while the percentage margins on sales are similar, the absolute dollar margin on sales in Australia in many cases may be larger. This would occur if the landed cost or cost of goods that Australian wholesalers and retailers source from overseas is high compared to other countries. This may arise from the transport costs incurred in shipping products to and within Australia, or because of international price discrimination practised by overseas manufacturers and suppliers.

A study by Kierath and Wang (2011) found that, when comparing average gross margins of store-based Australian retailers with store-based retailers in the United States and United Kingdom/Europe, those in Australia were higher in some categories (such as furniture and hardware) but lower in others (electronics). Compared to online retailers, gross margins were generally significantly higher, though this is expected given the inherent differences in cost structure between bricks and mortar and online retailers.

<sup>2</sup> The Commission is aware that definitions and descriptions of mark ups and gross margins vary, with some regarding mark ups as percentages based on either cost or sales, and gross margins defined in absolute amounts while others use the terms interchangeably. For the purposes of this report, the Commission is distinguishing the two terms as described above.

**Table 6.3 Gross margins by retailer category**

Average percentages

<i>Retailer category</i>	<i>Australia</i>	<i>United States</i>	<i>UK/Europe</i>	<i>Global Online</i>
Department stores	44	38	44	24
Electronics	22	23	31	35
Apparel	60	49	61	51
Furniture & Hardware	54	35	33	na
Jewellery	na	59	71	44

**na** Not available.

Source: Kierath and Wang (2011).

According to Kierath and Wang (2011), labour costs and rental expenses can be as high as 70 per cent of the Australian retail industry’s operating costs — high by global standards. Indeed many submissions from Australian retailers attributed higher retailer margins to the comparatively high costs of doing business in Australia. According to the Australian Retailers Association:

The reality is that Australian retailers work off higher gross margins in order to cover their costs of doing business in Australia. Typically, a retailer in Australia may mark a product up by at least 100% on its cost to market its selling price. A similar retailer in the USA may only mark that same product up by 50% and in the UK by 75%. (sub. 71, p. 10)

Myer states that:

In Australia, retailers pay higher fixed wages, penalties and conditions than in China, India and the UK. We pay higher rents than all the other major countries in the world ... as a result, our cost of doing business is higher and it is harder for Myer and other Australian retailers to compete on a world scale. (sub. 88, p. 10)

## **Key cost drivers**

Key cost drivers of retailers can have a significant impact on final retail prices to consumers and explain some of the pricing disparities between retailers and retailer-types.

### *Wage and labour on-costs*

Wage and labour on-costs are important cost factors and points of difference between bricks and mortar and online retailers. While bricks and mortar stores have staff on hand to give advice to shoppers (such as, the location of goods in the store, taking payments, or offering product advice), online retailing has largely shifted this responsibility to consumers. Consumers can now search for goods online and

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become informed about specifications and quality through peer reviews and forums, and facilitate their payment through online systems from the comfort of their own homes.

The reduced need for staff in online stores compared to bricks and mortar stores not only means lower wage costs, but also other labour related imposts such as penalty rates, loadings, superannuation and other employee conditions and labour on-costs.<sup>3</sup> Indeed, many participants raised concerns about Australia's high labour costs and regulation as adversely impacting on Australian bricks and mortar retailers' competitiveness with online retailers (domestic and international). Workplace regulation issues are addressed in chapter 11.

### *Occupancy costs and rent*

Online retailers have a clear cost advantage when it comes to having a virtual shopfront, in contrast to the actual shopfront of a bricks and mortar retailer. Retail occupancy costs involve a number of components, including fit out costs, marketing expenses and outgoings such as security, cleaning and insurance expenditures, in addition to base and turnover rent.

Online retailers have lower expenditure in this regard, with costs generally involving IT development and maintenance, online advertising, as well as occupancy costs for distribution, which is usually located away from the more expensive retail hubs. Australian pure online ('pure play') retailer Deals Direct, for example, use a 40 000m<sup>2</sup> warehouse for its goods distribution and, because of its location and the nature of the online retail model, its costs are lower:

Paying industrial rent gives the company an edge in costs, said [co-founder] Mr Greenberg. Add to that the fact that shopping strip outlets can typically only trade during the day to cover rent and other costs. "Our shop never closes." (Zappone 2011, p. 2)

Planning and zoning restrictions have constrained the supply and location of retail space which has led to increased rents for some retailer tenants. Upward pressure on rents appears to be strongest where occupancy rates for tenancies are highest and tenants have little bargaining power vis-à-vis their landlords, that is for (non-chain) specialty retailers in shopping centres (chapters 8 and 9).

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<sup>3</sup> With an increase in online retail, however, this would see higher demand for employment in warehousing, distribution and information technology areas (more 'back of store' rather than 'front of store' positions).

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### *Australian wholesaler and distributor prices*

Some Australian retailer submissions highlighted that wholesaler or distributor prices put pressure on their costs of goods and, as a result, their sales prices to consumers. Bicycle retailer Mainly BMX describes the price of an identical good which is sold in the United States directly to consumers at roughly the same price it faces from its local distributor (to which it would still need to add a margin). This results in them having a higher and non-competitive selling price:

... A BMX frame from US retailers at US\$369.99 plus US\$80 shipping to [Australia]. Our cost from the Australian distributor is \$355 plus GST plus shipping. (sub. 56, p. 1)

The Australian Automotive Aftermarket Association comments on the restrictions placed on retailers by Australian manufacturers and distributors:

Competitiveness is extremely difficult, with opportunities limited to when a manufacturer will only supply via a distributor agreement which has a strict no internet selling policy. They are then subject to competition via parallel imports from overseas based distributors. (sub. 38, p. 4)

Manufacturers and supplier restrictions are not limited to bricks and mortar retailers. Geoff Kingsel states that Australian online retailers remain uncompetitive with overseas online retailers because of pressure from major stores on Australian manufacturers and distributors:

... major stores have such an influence over the manufacturers and distributors, that pricing is forced up on the Pure Play Stores [online retailers] in order for the major stores to compete ... consumers are choosing to shop online overseas instead of online in Australia because of this. (sub. 69, pp. 1-2)

According to eBay, exclusive distribution agreements were a key impediment to trading for many sellers on its website. According to its 2011 Online Business Index survey results:

- 78 per cent of respondents noted that manufacturers had attempted to restrict online sales
- 28 per cent of respondents had found suppliers imposing conditions on online sales
- 25 per cent of respondents had found suppliers attempting to control the price of online sales of their goods (sub. 101, p. 35).

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The Commission recognises that the behaviour of suppliers/manufacturers described above by eBay may indicate anti-competitive conduct and has referred the submission to the ACCC.<sup>4</sup>

Therefore, restrictions and unfavourable contracts between Australian retailers (both bricks and mortar and online) and local wholesalers/distributors can increase their costs and lead to higher retail prices for consumers, compared to online retailers abroad.

#### *Other retailer-specific costs*

Other costs can contribute to final retail prices and partly explain differences across retailers. For example, the Australian Music Association emphasises the significant compliance costs of sector-specific regulatory burdens which are factored into Australian retail prices, but which are not factored into the same or similar products purchased from offshore channels. As an example for its goods:

Authorised Australian importers must invest thousands of dollars in ensuring “C-Tick” certification for thousands of products as varied as wireless microphones for singers to home entertainment systems ... we have historically been supporters of the strict safety and compliance systems ... however, these policy settings are now one of the factors pushing Australian customers towards buying the same or similar product from offshore. (sub. 68, p. 5)

Inventory and storage costs, the cost of finance and advertising and fit-out costs can also contribute to the cost structure of retailers, which may impact on pricing.

#### *Government taxes*

Government taxes can also influence retail prices and contribute to some differences between retailers. The GST and customs duty on retail goods is a concern for many Australian bricks and mortar retailers, who believe the \$1000 minimum threshold gives international online retailers an unfair competitive price advantage over Australian retailers. This issue is discussed in chapter 7.

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<sup>4</sup> In recent years, the ACCC has taken action on several occasions in relation to vertical pricing restraints. In one case, the sports eyewear supplier Dragon Alliance South Pacific Pty Ltd admitted it had engaged in resale price maintenance by trying to stop online retailers from discounting. In a second case, Oobi Baby, a designer, importer and distributor of infant toy and clothing products, also admitted to engaging in resale price maintenance and was ordered by the court to pay \$40 000 in penalties (ACCC 2008c, 2011h).

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More broadly, tax compliance and administrative burdens on Australian businesses (including those on retail businesses) such as payroll tax, workers' compensation and other taxes which employers have to pay, add to the costs of running a business. The Australian tax system was examined in the 2009 Australia's Future Tax System Review (AFTS 2009), and many complexities and inefficiencies within the system were highlighted. The review recommended ways to simplify and streamline Australia's tax system to 'reduce system complexity and business compliance costs'. The Government's response to the review saw only a limited take up of the recommendations, with consideration of other matters either rejected or deferred.

## **Profit margins**

A portion of gross margin or mark up, for wholesalers/retailers or any business, would be allocated to profits. The extent of a retailer's profit margin on a good depends primarily on supply and demand conditions, including the extent of competition for that good.

Profit margins in Australian retail are significantly lower than in other industries but, as noted in chapter 3, this is true of retail internationally due to its relatively low level of capital intensity. It should be noted that in general profitability is heavily influenced by firm size. Larger retailers generally perform better in terms of profitability than smaller retailers and, according to Citi Investment Research and Analysis (2011b), Australia's larger retail firms enjoy higher profit margins than their overseas equivalents. But variations exist from retailer to retailer. In its comparison of profit margins<sup>5</sup> for retailers in Australia, the United States and Europe, Kierath and Wang (2011) found significant variation across and within countries — in Australia, profit margins of 2.0 per cent for Dick Smith, 9.6 per cent for Myer and 16.7 per cent for Nick Scali were reported.

## **International effects**

Globalisation has led to an increasingly integrated marketplace for retail. While not all Australian retailers (for example, those in the food and grocery sector) will be exposed to international competition, many sectors of Australian retail not only compete with online retailers abroad, but they also engage with overseas suppliers as a part of their procurement processes and operations. The Australian Retailers Association (sub. 71) describes the Australian retail industry as being 'predominantly an import-dependent business' (p. 11). Other participants made similar observations:

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<sup>5</sup> 'Profit margins' here refers to EBIT (earnings before interest and taxes) over sales revenue.

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We directly import about 85% of the products we sell and source the remainder from local importers/distributors. (PowerSlide Racing, sub. 70, p. 1)

With minimal manufacturing in Australia, all major brands of bicycles are manufactured overseas and imported into Australia. (Bicycle Industries Australia, sub. 53, p. 3)

Goods are imported to Australia from New Zealand, but all business aspects of operations are run locally. (Sporting Edge Australia, sub. 51, p. 1)

As a result, many Australian retailers are exposed to international factors which can affect their performance and operations, as well as the pricing of their goods. The main factors raised by participants in this regard were:

- exchange rate effects
- international price discrimination.

#### *Exchange rate effects on retailers*

The favourable exchange rate and strength of the Australian dollar, particularly against the United States dollar (figure 6.2), has made the prices of many overseas goods more attractive to Australian consumers and contributed to their willingness to shop internationally online. However, the strong performance of the Australian dollar has also bolstered criticism that retailers have not passed on the exchange rate effects of cheaper input costs in the form of cheaper final prices for consumers.<sup>6</sup>

Some retailers are unable to pass on the cost reductions to consumers in a timely manner because of the nature of supplier contracts, which are often negotiated months in advance (Moses 2009). As the Australian dollar has trended up over the past decade (with the exception of a period in 2009 during the global financial crisis), Australian retailers in some cases have been selling stock purchased at lower exchange rates, consequently reflecting more expensive costs of goods, than can be bought at the current (and stronger) Australian dollar spot rate.

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<sup>6</sup> Of course, this argument suggests that retailers should pass on the exchange rate effects of more expensive input costs, in the form of higher final prices for consumers, at times when the currency weakens.

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**Figure 6.2 Australian Dollar against US Dollar**

January 2009 to October 2011

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*Data source: RBA (Exchange Rate Data [www.rba.gov.au/statistics/hist-exchange-rates/index.html](http://www.rba.gov.au/statistics/hist-exchange-rates/index.html)).*

Many submissions highlighted the timing complexities of exchange rates affecting retailers and their pricing of goods. Wholesale Diving Supplies states that, unlike consumers who can take immediate advantage of exchange rate changes in online purchasing, retailers are more restrained:

Australian retailers have to wait 6 to 12 months for the flow on effect and benefit of exchange rate movements because it takes this long to get the goods from the manufacturer, shipped through the wholesaler and then to the retailer. (sub. 59, p. 5)

PowerSlide Racing raise the point that consumers expect a strengthening Australian dollar to reduce their prices, but that this was difficult in practical terms:

The consumers do not realise that with 2000+ products we cannot simply alter prices on all of them on a weekly or even monthly basis due to exchange rate fluctuations. (sub. 70, p. 1)

John Swainston highlights the difficulty of retailers responding immediately to rate changes because of the nature of forward planning of importers, some of whom will buy forward cover to lock in an exchange rate in order to protect against large fluctuations:

Importers, required to offer consistent prices to their customers, take a midway path in currency planning for such broad swings in currency ... this insulates their retail clients from excessive negative bumps in the low point of the A\$ cycle ... this is then reflected in an importer's inability to fully reflect exchange rate parities in pricing. (sub. 22, p. 2)

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Further, exchange rates were deemed irrelevant for many elements of retailers' cost structures, which explains why they did not have a direct flow on effect on final prices faced by consumers. International Dynamics submit that:

Costs don't automatically change in line with exchange rates. Running a warehouse, paying staff, advertising, servicing and other operational costs are not directly affected ... they are a very substantial part of the costs of business. (sub. 26, p. 4)

Therefore while exchange rate changes can have an immediate impact for consumers online, Australian bricks and mortar retailers may not be able to take advantage of currency changes as quickly. If further appreciation of the \$A occurs, however, over time many retailers should be in a position to pass on exchange rate benefits to consumers as contracts with suppliers are renegotiated.

#### *International price discrimination*

Another factor contributing to differences in retail prices is international price discrimination. International price discrimination occurs when a single seller offers different prices for identical goods to buyers in different countries.

More broadly, the practice of price discrimination is a common and generally legal business strategy to maximise profits and performance (box 6.3). It is sustained through sufficient demand from consumers, lack of competitive rivals, and the ability for market and/or consumer segments to be kept separate (that is, there are often restrictions on those that are charged a cheaper price to prevent them reselling their goods to other consumers who are charged higher prices).

While submissions and media articles are largely concerned with retail price differences in terms of 'price dispersion' concerns, international price discrimination has also been raised from a consumer perspective, particularly for goods such as music and software downloads which do not have explicit shipping costs to explain price differentials (box 6.4).

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### Box 6.3 Retail price discrimination

Price discrimination in retail can refer to:

- first degree price discrimination — this occurs when retailers are able to determine the amount *each consumer* is willing and able to pay for a good and charge different prices accordingly
- second degree price discrimination — this occurs when retailers offer different prices to consumers depending on the quantity of goods bought. Bulk buyers, given lower unit price costs, enjoy higher discounts
- third degree price discrimination — this occurs when retailers distinguish between *segments of consumers*, based on willingness and ability to pay for a good and charge different prices accordingly.

While first degree price discrimination is rarely seen in practice, as retailers generally lack such full information (consumers would be unwilling to reveal their reservation prices for goods), the internet and digital technology may change this:

... technology allows firms to identify and track individual consumers ... the Internet retailers' Web server can deploy complex pricebots and algorithms to determine prices to approach first degree price discrimination. (Ghose et al. 2002, p. 1)

On the other hand, examples of second and third degree price discrimination in retail are common ('buy 1 get 1 free' deals is an example of the former and differential movie ticket prices for seniors is an example of the latter).

Sources: Gardner (2011); PC (2009a).

International price discrimination against Australian retailers has also been raised in submissions as being an important contributing factor to retail price dispersion. Specifically, this discrimination is in the form of brand owners or international suppliers/manufacturers charging higher prices to Australian retailers relative to the prices they charge to similar retailers in other regions. These comparatively higher international supplier prices are then passed on to consumers.

While regional pricing strategies in themselves are not prohibited under the *Competition and Consumer Act 2010* (the Act), certain behaviour employed to underwrite regional pricing strategies can in some circumstances raise concerns under the competition provisions of the Act. For example, suppliers may attempt to engage in resale price maintenance (prohibited under the Act) or impose conditions on resupply which may raise concerns under the exclusive dealing provisions of the Act where such conditions have the effect of substantially lessening competition. The ACCC would need to consider any behaviour on a case by case basis to determine whether it raised concerns under the competition provisions of the Act. It is important to note that there are some exemptions to the Act for certain conduct

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related to intellectual property in order to promote innovation (while balancing this with broader competition policy goals).<sup>7</sup>

#### **Box 6.4 Apple's international price discrimination**

The differential pricing of applications, video and music downloads from iTunes (Apple) is a common example raised as reflecting international price discrimination against Australian consumers:

... the inexplicably higher prices at Apple's iTunes store for Australians are well known ... Apple's charging of Australians more for the same stream of 0s and 1s compared to Americans continues — the new Beastie Boys album currently costs Americans US\$9.99 but more than twice as much, \$20.99, via iTunes in Australia. (Keane 2011, p. 1)

For Apple, strong brand loyalty from consumers which drives high demand for their products and a lack of competitive rivals in Australia may have helped sustain a level of price discrimination:

Australia has been pretty slow to challenge Apple with music streaming sites and consumers simply aren't aware of their options ... the only reason Apple charges cheaper prices in the UK and US is because they have a much more competitive environment. (Gardner 2011, p. 1)

On the other hand, it is unclear whether iTunes USA and iTunes Australia can be regarded as the same supplier. While they may be commonly owned, they are likely to have their own marketing, administration and distribution budgets. Costs associated with the distribution of Australian specific content and marketing could mean that higher fixed costs apply to the Australian subsidiary. But given the costs associated with the distribution of music and other media are only likely to be a relatively small share of total costs, this does not fully explain or justify the price differential.

Some online forums have suggested other music and video streaming sites as substitutes for Apple, while others describe how Australian consumers of iTunes can bypass discrimination by purchasing US Apple gift cards and/or by using fake American billing addresses (in turn, breaching Apple's terms and conditions) — thereby eliminating the ability for market segmentation (a factor which maintains international price discrimination).

In July 2011, Apple reduced its price of iTunes Apps (applications) by 25 per cent in Australia and some other countries. According to Apple Australia, this adjustment was made:

... due to changes in foreign exchange rates and local tax laws. (Moses 2011b, p. 1)

Sources: Moses (2009, 2011a).

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<sup>7</sup> Section 51(3) of the Competition and Consumer Act exempts certain intellectual property rights from some provisions of Part IV of the Act. The National Competition Council (1999) recommended that s. 51(3) be amended to remove some protections that might be anti-competitive. The Ergas Committee report (Ergas 2000) further recommended amendments to s. 51(3) and the Australian Government, in its response, accepted them in part. However, the Commission is of the understanding that no changes have been implemented since.

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Recent media articles and studies have conducted price comparisons of identical goods offered by retailers in Australia and retailers in the United States and found significant disparities (Griffith 2011; Keane 2011; Irvine et al. 2011). However, in addition to the varying cost drivers discussed previously, it is important to keep in mind that the US market is much larger and more competitive than the Australian market.

Australia finds itself as a country nearly the same physical size as the USA, but with just 22 million inhabitants vs. the 310 million of the USA. Minimum wage rates, local taxes, sales tax and a host of other variables still enable the physical exploitation of markets in the US to be amortised across a market 13x greater than the Australian population. (John Swainston, sub. 22, p. 3)

The importance of size in this context translates into lower cost structures for US retailers, but most importantly, the intensity of competition is much higher in the United States and there are many alternative choices that consumers have on offer.

Given Australia is a relatively small player in the global retail landscape, particularly compared to the major United Kingdom and United States markets, Australian retailers may not be able to access as favourable conditions and prices for their imported goods. In the same way that consumers may be offered lower prices for higher quantities of purchased goods, retailers could face similar issues with manufacturers and suppliers — the larger volume they would acquire, the more favourable terms and prices they would be able to negotiate (reflecting ‘second degree price discrimination’). Even if the good is manufactured at the one location and being supplied to retailers around the world, the extent of volume, discount and buying clout can differ among retailers (box 6.5).

A seemingly minor difference in manufacturer prices charged for goods at the beginning of a supply chain can also have significant flow-on effects and, compounding with higher costs throughout the supply chain, lead to large differences in the end retail price of a good for consumers.

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### Box 6.5 Australian retailers' position in the global context

According to the Australian National Retailers Association:

... members also report that some international manufacturers use differential pricing policies that can mean Australians pay higher prices than in other markets. These practices leave Australian retailers that are operating within traditional supply-chain frameworks at a competitive disadvantage. (sub. 91, p. 29)

The Australian Retailers Association similarly draws attention to the supply chain costs which Australian retailers face, compared with overseas retailers:

Australia's access to the supply chain is often limited by the size and scale of our domestic retail industry and also results in increased wholesale prices imposed by suppliers in the country of manufacture which is an additional price point which needs to be factored in for the Australian consumer, compared to a product exported to a larger economy, such as the United States. (sub. 71, p.11)

The Photo Marketing Association states:

The largest global markets have long been offered lower FOB [free on board] prices, because of the size of the orders placed by traders from large markets (USA) or countries who pay in advance and have low costs of distribution ... Australian independent distributors will typically have paid between 5 and 15% more for goods ex-factory than their US counterparts. (sub. 40, p. 4)

The Fair Imports Alliance contends:

Australia's position in the supply chain, as the proportion of the international market for imports into Australia, is not significant. This often results in the orders of Australian retailers and wholesalers, particularly for specialist consumer goods being placed at the end of the queue by overseas manufacturer suppliers. Australia's access to the supply chain is often limited by the size and scale of our domestic retail industry and also results in increased wholesale prices imposed by suppliers in the country of manufacture ... (sub. 47, p. 9)

However, the extent to which international price discrimination and unfavourable distribution channels are maintained also depends on the ability — and willingness — of Australian retailers to preserve such supply links. Consumers, for example, are increasingly able to bypass local suppliers and retailers by purchasing directly from overseas suppliers, with many websites providing buyers with improved opportunities to source products at the cheapest price (though these are not all without costs). Retailers may also have the ability to take advantage of similar approaches or use alternate and less costly supply channels to reduce final prices for consumers.

Australian retailer JB Hi-Fi highlighted the option of changing supply links in order to compete with online retailers, with Chairman Patrick Elliott stating:

It remains open to JB Hi-Fi to import directly and effectively bypass Australian representatives of multinationals ... if we have to go to a direct-import model ... we will. (Wilson 2011, p. 68)

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Generally, there are growing opportunities to circumvent geographic barriers that have traditionally facilitated international price discrimination. Over time, this is likely to put pressure on the maintenance and extent of international price discrimination.

### *Parallel importation of goods*

One way in which regional pricing strategies of a supplier may be avoided is through the practice of parallel importation. Parallel importing of goods represents an alternate supply channel which can undermine market segmentation, and refers to the importation of identical and genuine goods by someone other than the licensed or authorised distributor:

... some enterprising middleman buys stocks in the cheaper foreign country and imports them into the dearer, domestic country. (Shoko and Krivokapic-Shoko 2005, p. 1)

As W Lawyers explain:

Parallel imports are legitimately produced goods imported into another country. The goods are manufactured with the authorisation or consent of the intellectual property owners and subsequently imported into another country by an unauthorised distributor. Unlike pirated (counterfeit) goods, parallel goods are genuine and manufactured by the intellectual property owners, or licensee of the owner.

The benefit of parallel imports is it hinders international price discrimination and abuse of market power promoting free trade and competition. Without parallel imports an intellectual property owner can separate markets without fear of competition and charge different prices in each country. The intellectual property owners can also restrict supply preventing a range of available products to consumers in specific countries. The most important beneficiaries of parallel imports are consumers who receive the advantage of genuine goods at lower prices. (sub. DR220, p. 1)

Generally speaking, parallel importing goods and reselling them in Australia is not illegal — although the overseas supplier may be acting inconsistently with its arrangements with their local distributor. The Act does not prevent an Australian retailer from advertising or supplying the products. However, retailers selling these goods must ensure they do not mislead or deceive consumers or misrepresent the origin of the goods. For example, the retailer may need to disclose any warranty issues or differences in the quality or style of the good. Consumer protection concerns may arise where the packaging of the local and imported goods are similar, but there is a difference in quality or performance (chapter 5). Box 6.6 describes a supplier and retailer dispute relating to parallel imported goods and perceived differences in quality.

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Parallel importing gives consumers access to more goods, enhances competition (putting downward pressure on prices) and also offers a potentially cheaper supply channel for retailers. One of the main incentives for Australian retailers to trade in parallel imports for resale in Australia is that, in many cases, the local wholesale price is considerably higher than the overseas prices. Red Herring Surf shop, for example, acknowledges the cost advantage that parallel importing could have on their business (though it alluded to restrictions preventing them doing so):

Yes, if we could import direct at a cheaper price, we would then sell the goods at a cheaper price. (sub. 41, pp. 4-5)

**Box 6.6 Nestlé Australia and Aldi dispute over Nescafé parallel imports**

On 2 December 2005, Nestlé Australia lodged a notification to the ACCC regarding the selling of imported Nescafé coffee products by retailer Aldi. Nestlé Australia claimed that Aldi, in selling Nescafé brand instant coffee manufactured overseas in proximity to Nestlé Australia's Nescafé Blend 43 products, was misinforming consumers about the difference between the products:

Nescafé Blend 43 coffee is a unique coffee that is sourced, blended and roasted in a specific way to meet the sophisticated taste of the Australian market and is distinctly different from the 'Nescafé Classic Deluxe' and the 'Nescafé Matinal' branded coffee manufactured in Indonesia and Brazil respectively. (ACCC 2006b, p. 3)

In order to reduce consumer confusion, Nestlé Australia requested that Aldi provide sufficient promotion, advertising and marketing (including prominent stickers and signage at point of sale) emphasising the differences. Without such changes, Nestlé Australia would not supply Nescafé Blend 43 and other Nescafé Australia products to Aldi.

On 3 August 2006, the ACCC revoked Nestlé Australia's notification on the grounds that Aldi had sufficiently differentiated between the internationally and locally sourced Nescafé coffee products in their stores, and that the notified conduct of Nestlé Australia (in restricting supply of their products unless Aldi complied with their requested changes) constituted anti-competitive behaviour — with the dual purposes of:

... eliminating a new source of competition for the Australian Nescafé instant coffee brands [and] ... remove the stimulus to other Australian grocery retailers who might respond to ALDI's sale of the imported Nescafé coffee brands by discounting Nescafé Blend 43 or by importing the same or similar products. (ACCC 2006b, p. 33)

Source: ACCC (2006a).

However, some retailers — while cognisant of the perceived benefits — highlighted the potential risks of parallel importing from a consumer quality perspective. For example, goods may lack warranty support from licensed distributors in Australia or

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carry labelling which does not comply with Australian laws (Accord, sub. 75; Australian Music Association, sub. 68).

The Boating Industries Alliance of Australia raises similar concerns regarding the non-compliance with Australian standards and regulation of parallel imported goods, but also highlights their impact on local industry:

The Australian industry (across a range of sectors) is still developing. This is particularly the case in regional centres of Australia. Where parallel imported product is dumped into those markets it not only reduces the growth potential of authorized industry participants but also potentially damages the image of authorized operators when the consumer has problems with parallel imported products. (sub. 97, p. 11)

While the Boating Industries Alliance of Australia suggest options to restrict parallel importing, including the development of Australian product standards to apply to all goods (including those imported), these measures seem akin to protection from what consumers would see as healthy competition. While restrictions on competition in retail would shelter some retailers from competitive pressures, this would also adversely affect the availability and prices of competitive goods for consumers. In the Commission's study on parallel import restrictions (PIRs) on books, the wider repercussion of PIRs on the broader economy was addressed:

... the higher prices for books that underpin [PIRs] are ultimately paid for principally by consumers and there are attendant effects on activity and employment elsewhere in the economy. Without the PIRs and the upward pressure on book prices they have sustained, enhanced consumer spending power could have translated into additional demand for other goods and services, generating employment and business opportunities in other sectors. (PC 2009b, p. 7.3)

Measures protecting activities from competition, in general, are not in the interest of the Australian community. The Commission thus recommended the repeal of Australia's PIRs on books in Australia and deemed their removal would generate net benefits for Australia as a whole:

The current PIR regime is unnecessarily costly for consumers, restricts the commercial operations of booksellers and is not a well targeted mechanism for supporting cultural externalities. Reform is necessary. (PC 2009b, p. 7.1)

While the Commission recommended changes to permit wider parallel imports of books, the Government, in response to concerns from a number of stakeholders, ultimately announced it would not change the existing law.

Submissions from some retailers to this inquiry suggest some reluctance to pursue alternative supply chain arrangements, in order to preserve current channels. Myer (sub. 88) acknowledges that overseas online competitors were offering the same

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cosmetic products at a significantly lower retail price, with the supplier cost playing a part in this. While recognising that cosmetics in Australia could be sourced through other channels, Myer states a preference to maintain local supplier links:

We purchase our internationally branded cosmetics through local distributors and we have strong relationships with many of these suppliers. Myer and other retailers are supported by cosmetic suppliers through marketing, markdown funding, staffing support, and cosmetic fit-outs ... if we were to purchase from either the grey market or through the US we could forgo the support of the local suppliers. (sub. 88, p. 12)

While alternate supply channels could potentially be cheaper, Myer seems reluctant to pursue these avenues and instead is opting to maintain the status quo and emphasise the non-price benefits of its offerings:

... variation in price for the same *Product X* available to consumers from overseas websites is not insignificant. However, online sites are not able to replicate the in-store experience, theatre, MYERone rewards and events, nor our exclusive brands. (sub. 88, p. 12)

Woolworths (sub. 110, attachment) states that despite the seemingly straightforward strategy of changing supply channels to alternative and perceived cheaper suppliers, there are several challenges for retailers in doing so:

... whilst activities such as parallel importing are an effective way of delivering products to customers, there are considerable compliance issues which mean that its use on a broad scale is limited ... the extended lead times in sourcing and bringing products to market and associated costs further impede retailers' ability to parallel price. (sub. 110 attach., p. 55)

Uncertainty in supply, quality assurance and testing of goods, legal and trade mark checks, customs compliance and distribution burdens have also been raised as concerns for retailers in sourcing from parallel imports.

It is clear that international price discrimination is being practised against some Australian retailers, to the detriment of Australian consumers. Some Australian retailers have the option of altering their supply arrangements — either by putting pressure on existing international suppliers and distributors or else changing their supply channels. While some retailers state they are restricted in changing their supply channels, their willingness to do so would also depend on consumers' demand for their relatively higher priced goods. Without consumer pressure on their prices, retailers face little incentive to alter their sources of supply. With growing competitive pressure from online and overseas retailer competition, however, this may change:

It appears Australian retailers are all too happy to pass on high wholesale prices to local consumers. If Australian retailers are not concerned about keeping their prices

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competitive, they will continue to lose customers to their overseas competitors. (Brewster 2011)

Reserve Bank Governor Glenn Stevens noted this pressure on Australian retailer costs:

... with the higher Australian dollar, the component of the retail ‘product’ that is added in Australia — the local distribution and retailing overheads that are required to provide the retail ‘experience’ — has become both much more visible, and much higher *relative to* the production cost of the good itself. So the incentive for the consumer to avoid those overhead costs has increased quite noticeably. The sector is therefore under pressure to reduce those costs. (Stevens 2011, p. 1)

### *Copyright and restrictions on parallel imports of clothing*

Concerns were also raised in submissions in relation to copyright restrictions which have prevented some retailers and distributors from importing and selling clothing which embodies decorative graphic images sold with the copyright owner’s permission in another market (Mur Thai Food Co., sub. DR237; Paul’s Warehouse, sub. DR228).

According to W Lawyers (sub. DR220), a major issue affecting the growth and success of some Australian retailers is the parallel import restrictions of artistic works placed on branded clothing and footwear relating to the *Copyright Act 1968*:

... the current copyright law is failing to protect Australian retailers from litigation by brand owners in the instance where a trade marked good bearing copyright material, which does not meet the definition of packaging or a label, will infringe the owner’s copyright. For example, if an Australian retailer parallel imports branded goods bearing a decorative graphic found to subsist in copyright that is printed on the surface of clothing and footwear, this act will be an infringement of the owner’s copyright. (sub. DR220, p. 2)

Local retailer, Paul’s Warehouse, suggests that:

... such restrictions are preventing Australian retailers from purchasing competitively priced genuine goods overseas (rather than the inflated prices of the Australian distributors) [and this] is a primary factor why Australian retailers of branded clothing and footwear are paying higher prices for legitimately manufactured goods than overseas retailers selling products direct to the Australian market through the internet. (sub. DR228, p. 1)

Copyright protection allows a copyright owner to control the distribution and sale of an article containing a copyright protected work or other subject matter after the article has been sold with the owner’s permission. In Australia, the Copyright Act imposes the general concept of ‘national exhaustion’ on parallel imports for

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commercial sale — as opposed to ‘international exhaustion’.<sup>8</sup> This means the copyright owner loses the ability to control the commercial exploitation of goods released in the domestic market with the owner’s consent. But the copyright owner (or authorised agent/licensed distributor) can still oppose the importation of articles marketed abroad. In other words, with a national exhaustion approach to copyright, copyright owners can prevent the resale of parallel imported goods and thereby restrict competition.

During the period 1991-2003, a number of amendments (or ‘carve-outs’) were made to the Copyright Act by successive Australian Governments to permit parallel imports in specified circumstances covering:

- books (ss. 44A and 112A) (but due to stringent conditions, parallel imports are still highly restricted)
- accessories to imported articles (ss. 44C and 112C)
- sound recordings (ss. 44D and 112D)
- computer programs (s. 44E)
- electronic literary and musical items (ss. 44F and 112DA).

The present effect of the Copyright Act is that copyright owners of artistic works have a right to control parallel imports of their works, except where the work is embodied in an article that may be parallel imported (that is, the carve-outs or exceptions discussed above).

Generally, clothing and footwear are not items that are protected by copyright. However, under the Australian copyright regime it is possible for a licensed Australian distributor to prevent resale of parallel imports of these types of goods if there has been a breach of copyright of artistic works on clothing and footwear under the Copyright Act. In a recent Federal Court case, copyright was found to be infringed where a local retailer imported and sold clothing that included pictorial designs/artistic works that subsisted in copyright (box 6.7).

W Lawyers (sub. DR220) proposes changing the Copyright Act for artistic works in branded goods containing a trade mark in a similar manner to the earlier carve-outs discussed above. Such amendments would require a detailed examination of the costs and benefits to the Australian community of maintaining the current regime which restricts the resale of such parallel imports.

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<sup>8</sup> Under the concept of ‘international exhaustion’, the rights of a copyright owner to control distribution are exhausted once an article is sold with their consent anywhere in the world.

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## Box 6.7 Recent Federal Court case on copyright and parallel imports

In the recent Federal Court case of *QS Holdings Sarl v Paul's Retail Pty Ltd* (2011) FCA 853, the court held that Paul's Retail Pty Ltd (trading as Paul's Warehouse) could not resell parallel imported genuine branded goods if the product contained artistic works that subsist in copyright without the license of the copyright owner. This ruling was in relation to two garments bearing artistic works identified as the 'Bellview Bird' and 'Roots Lion' designs.

Paul's Retail Pty Ltd argued that it had an implied licence to import and resell the garments in Australia by reason of the fact that they were genuine articles sold to it by the copyright owner's authorised agent in the United States. However, the Court rejected this argument (based on previous case law):

A positive licence may in certain circumstances be implied, as for example where a copyright owner overseas sells copyright articles in commercial quantities to a purchaser in Australia. But that is very different from implying a licence to import into Australia for purposes of sale from the mere fact that the copyright owner made sales in his own country in commercial quantities to a purchaser in that country without expressly imposing a restriction on importation into Australia. It cannot be maintained that in such circumstances the copyright owner positively licensed the importation into Australia of the articles which he had sold on his own domestic market. (Judgement at 111)

As a consequence, the Court found Paul's Retail Pty Ltd had infringed copyright by importing and selling the designs in Australia — despite the fact that the goods were genuine and not in breach under the *Trade Marks Act 1995*. Indeed, the case demonstrates the strength of intellectual property rights, particularly copyright, in preventing parallel importation and sale of goods despite trademark considerations.

More generally, as part of its submission, Paul's Retail Pty Ltd put forward a public interest argument to allow the importation of genuine goods and prevent copyright owners seeking:

... to control the market for their goods by the enforcement of copyright in circumstances where relief is not available under the Trade Marks Act because of s 123. (Judgement at 125)

In response, the judge stated:

This submission involves considerations that lie outside the purview of this litigation and, in the absence of a relevant law, are not for this court to decide. (Judgement at 126)

Source: *QS Holdings Sarl v Paul's Retail Pty Ltd* (2011) FCA 853.

Conceptually, parallel import restrictions are similar to other import restrictions in that they benefit local producers by cushioning or shielding them from foreign competition. Experience in other sectors of the economy has shown that parallel import restrictions can adversely affect consumers, particularly through the prices of the goods concerned. In effect, they involve a transfer of income between different groups and sectors in the community, benefiting local distributors/artists primarily

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at the expense of consumers and local retailers. While most of the direct benefits and costs are likely to be offsetting, there may be some additional ramifications for community wellbeing, to the extent that parallel import restrictions generate:

- cultural externality benefits
- leakage of income to foreign copyright owners
- economic efficiency costs.

On 25 February 2011, the Attorney General announced his intention to provide the Australian Law Reform Commission with a reference on copyright (McClelland 2011). While the terms of reference are not yet available, this issue should be examined as part of that review.

RECOMMENDATION 6.1

*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 clothing or other goods which embody decorative graphic images sold with the copyright owner's permission in another market.*

*Copyright and trademarks law result in different outcomes for parallel imports*

An additional concern raised by W Lawyers is that trademark law and copyright law are inconsistent:

The *Trade Marks Act 1995* provides that an owner of a mark who registers its trade mark has the exclusive right to use the trade mark. However, if goods have been applied a trade mark with the consent of the registered owner then the owner cannot prevent further resale in Australia of those goods. Consequently, the existing copyright and trade mark regimes are contradicting each other with the copyright legislation preventing parallel importing, and the trademarks legislation allowing parallel imports to be sold to Australian consumers. (sub. DR220, p. 2)

The inconsistency in outcomes arises because the respective legal regimes control different forms of intellectual property — they are administering different policy frameworks. In general, trademarks indicate the goods originate from a particular trader (that is, they are genuine branded goods). On the other hand, copyright in artistic works protects the intellectual creativity of an author as expressed in an original material form. For example, for trademarks, a shirt is an article of clothing — and the issue is accurately identifying its maker to consumers. For copyright, a shirt embodying a graphic design or image which is an artistic work is a reproduction of that work — and the issue is the right of an author/rights holder of

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an artistic work to control the distribution of reproductions for sale in different markets.

The law as it stands appears to have undesirable anticompetitive effects and confers more power on the owner of the copyright than applies in the case of the owner of a trademark. As a general rule, the Trade Marks Act has a broad acceptance of parallel importation with respect to trade marks,<sup>9</sup> while the Copyright Act has a broad prohibition on the resale of parallel imported goods which embody reproductions of original works (but subject to specific exceptions as discussed in the previous section).

### 6.3 Conclusion

Price differences in retail is not a new phenomenon. The internet has made price disparities more transparent, but the role of the consumer has not changed. There will often be price differences in goods from one retailer to the next, and it is up to consumers to shop around and search out the best price — irrespective of whether it is across bricks and mortar or online retailers — given their individual preferences. The Commission considers that Australian consumers will buy goods where they feel they get the best deal regardless of retail format and that retailers that do not, or are unable to, respond effectively to competitive pressures will face serious challenges.

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<sup>9</sup> A recent case, *Sporte Leisure Pty Ltd v Paul's International Pty Ltd (No 3)* (2010) FCA 1162 (29 October 2010), signalled that importers are not always protected by s. 123 of the *Trade Marks Act 1995 (Cth)*. Ambiguity can arise from the definition of 'consent' or 'owner of the trade mark' and territorial restrictions may still apply. See Moore (2011).

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## 7 Appropriateness of current indirect tax arrangements

### Key points

- Most imports are subject to a low value threshold (LVT) of \$1000. Imports below this threshold are generally not subject to indirect taxes, fees and charges, or the requirement for a full import declaration. This distorts consumer choices in favour of overseas online retailers. However, the Commission considers that this is not the main factor affecting the international competitiveness of Australian retailers.
- As the GST is a broad based consumption tax the LVT should, in principle, be reduced to a low level to ensure tax neutrality. But the costs of collecting additional revenues must be balanced against the gains from removing the distortion.
- Around 58 million international parcels under the \$1000 threshold now arrive in Australia. Based on available data, the Commission estimates that with current parcel volumes and processing costs, removal of the LVT would generate revenue of around \$600 million at a cost of well over \$2 billion borne by businesses consumers and government.
  - In most scenarios estimated, total collection costs would still exceed additional revenues or generate net efficiency losses for the community. Significant reductions in collection costs per parcel are required to generate positive outcomes.
- Other countries, with lower thresholds, have put more effort into streamlining revenue collection and the collection of taxes at point of sale by some overseas online retailers. However, there is very limited published material describing the policy framework used in setting their thresholds, and little information about their assessment of the costs and benefits of different threshold levels.
- The Government should establish a taskforce to develop a new approach, based on international best practice, to process parcels with the objectives of:
  - minimising delays in the delivery of parcels to businesses and consumers
  - collecting taxes efficiently and passing on the collection costs to the consumer
  - accommodating the expected growth in the number of international parcels.
- The costs and benefits of implementing new arrangements should be assessed.
- The LVT should only be lowered if it can be demonstrated that it is cost effective to do so — the costs of raising this additional revenue should be at least broadly comparable to the costs of raising other taxes.

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## 7.1 Low value importation threshold

The customs barrier aims to achieve a number of objectives relating to control of the movement of goods into Australia. It provides a mechanism to prevent both the entry of prohibited imports into Australia and to collect taxes on imports. To facilitate the efficient flow of goods, and the cost effective collection of revenue, most low value imports are exempted from the collection of taxes.

The current growth in the volume of parcels entering Australia, which appears to be largely driven by the growth in online shopping from overseas retailers, has placed pressure on the existing facilities of the Australian Customs and Border Protection Service (Customs) and Australia Post. At the same time, concerns about the impact on Australian retailers of overseas online shopping have drawn attention to the appropriateness of the existing arrangements for handling low value imports.

### Concerns raised by industry

Recently Australian retailers have raised a number of concerns about the impact of the low value threshold (LVT) for imports. The threshold exempts most imports with a value of less than \$1000 from GST, customs duty, fees and charges, and the requirement to complete a full import declaration. Retailers consider that the exemption gives overseas online retailers an unfair competitive advantage when selling low value goods to Australian consumers and businesses (box 7.1).

The exemption also results in a loss of GST and customs revenue for governments, which can be expected to grow if projected increases in online retailing are realised.

The submissions received by the Commission indicate that there are broad concerns across the retail industry, but some specific sectors seem to be particularly affected. Many submissions from bicycle wholesalers, retailers and industry bodies have outlined the problems their industry is facing. As discussed in chapter 4, a large volume of sales are going to overseas suppliers with the result that businesses report that they are finding it increasingly difficult to survive. Cycling businesses report customers examining goods in their stores, but buying online from overseas retailers, and in some cases bringing their overseas purchases into the store for installation.<sup>1</sup>

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<sup>1</sup> See: SCV Bicycle Imports, sub. 30; Yarra Valley Cycles, sub. 32; Slam Factory, sub. 33; Renegade Cycles, sub. 34; Strictly BMX, sub. 35; Hyperdome Bike Hub, sub 36; Sacred Ride, sub. 44; Blackman Bicycle Services Pty Ltd, sub. 52; Bicycle Industries Australia, sub. 53; Back Bone BMX, sub 54; ForTheRiders Bike Shop, sub. 55; Mainly BMX, sub. 56; Retail Cycle Traders Australia, sub. 57; Colony BMX Retail, sub. 58; KWT Nominees, sub. 76.

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**Box 7.1 Retailer concerns about the low value importation threshold**

In our view the Australian retail industry is no longer on a level playing field. With the influx of international e-tailing, Australian are disadvantaged due to the imbalance of GST and duty taxation. (BB Retail Capital, sub. 128, p. 1)

This entrenched disadvantage will ultimately drive the domestic competitor out of business, as one would expect in a competitive market. Domestic online retailers have survived, so far, because 'other' factors have protected them from the full effects of the regulatory advantages their international competitors benefit from when competing in the Australian market. (National Retail Association Limited, sub. 102, p. 3)

The exemption effectively subsidises foreign online businesses at the expense of Australian business, thus threatening their livelihoods and the jobs that they provide. (Star Audio Visual Association Inc., sub. 13, p.1)

Because no GST is charged on orders from OS retail sites we are unable to compete. The discrepancy means that we are losing sales and the Australian Government is losing tax revenue. If this trend continues unabated then retail in Australia will be devastated costing thousands of jobs and destroying many businesses. (Slam Factory, sub. 33, p. 1)

It is well known that a significant percentage of our industry's sales of component ensembles, racing wheel sets, higher-end road tyres, cycle clothing, and cycling shoes are being lost offshore. Anecdotally, I would estimate that between 5-20% of these categories and possibly 3-5% of overall sales is being lost. The percentages are growing steadily. (Renegade Cycles, sub. 34, p. 1)

Despite being regarded as a luxury industry the average sale per jewellery item amounts to no more than \$200.00. If other countries can manage to administer lower thresholds (refer Productivity Commission Issues Paper) Australia should be able to do likewise. A system needs to be implemented by the Australian Customs Authorities that will result in the efficient processing of lower valued items that will result in a net benefit. (Jewellers Association of Australia, sub. 65, p. 2)

Bicycle parts, clothing and accessories are often small and light in nature, offering themselves to be easily transported through air freight. This combined with the average price of goods being below the \$1000 Low Value Threshold (an internal industry survey identifying that 75% of product sold in Australian specialised bicycle stores is priced below \$1000) has supported the growing trend of offshore purchasing. (Bicycle Industries Australia, sub. 53, p. 3)

The low value threshold acts like a tariff in reverse to Australian online retailers, even if it is only a psychological barrier the fact that they know that the overseas competitors have got an unfair advantage in their favour in the beginning, this is sometimes all it takes to prevent investment. (Wholesale Diving Supplies Pty Ltd, sub. 59, p. 2)

Retailers in the footwear and clothing, sporting goods, toys, photography and jewellery sectors have also made similar submissions to this inquiry.

These pressures and changes are not unique to Australia. International experience suggests that some of the success of the online retail model may be more related to the characteristics of certain retail businesses and less to issues such as the low

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value threshold (LVT). The Australian Automotive Aftermarket Association (sub. 38) pointed out that in the United States 60 per cent of sales in the independent auto aftermarket sector are now made online. This sort of business involving a multitude of parts, which consumers want quickly, and where freight costs are probably a relatively small part of the total value of the goods, seems intuitively to offer large competitive advantages to a centralised online supplier.

The issues being raised by retailers have also been raised earlier in other fora. In 1998 the Joint Committee on Public Accounts and Audit (JCPAA) noted that:

Some Australian retailing groups advised the Committee that their viability was under threat from a combination of the screen free limit [*the duty and sales tax free limit and the commercial entry thresholds for imported goods*], an uncompetitive wholesale sales tax regime and the growth in internet commerce. It was claimed that the internet would lead to an increase in consumers taking advantage of the screen free limit. Second, Australian retailers argued that they could not compete against imported goods that were not subject to duty and sales tax. These groups suggested that if internet commerce reached its expected potential then the screen free limit would be exploited and would result in an unlevel playing field. (JCPAA 1998, p. 141)

In 2009, the Board of Taxation examined the LVT issue as part of a broader review of the application of GST to cross-border transactions. It concluded that any lowering of the threshold would likely increase administrative costs for the Government as more goods were brought into the customs system in order to account for GST and duty, and the additional costs were likely to outweigh any benefits. Moreover, consumers (and businesses) would have to pay disproportionately high costs including GST, duty and administrative charges to have their goods released from Customs compared to the actual value of the goods, if the threshold were reduced (Board of Taxation 2010).

## 7.2 The Australian threshold

The Australian Government has set a low value importation threshold of \$1000. Goods imported into Australia (including those purchased online) valued at less than \$1000 do not attract customs duty, GST, Customs and AQIS charges, and are subject to a lower level of reporting to Customs. The only exceptions are for alcohol and tobacco on which the full range of taxes and charges must be paid.

### Exemption from GST

The *A New Tax System (Goods and Services Tax) Act 1999* specifies that if goods are duty free under the Customs by-laws (because, for example, their value is below

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the threshold), they are also non-taxable importations. Otherwise GST is collected at the rate of 10 per cent of the Value of Taxable Importation. This value includes the customs value on which customs duty is assessed, any duty payable, transport and insurance costs, and Wine Equalisation Tax where applicable.

Where the recipient of a parcel is a business registered for GST, the threshold has little practical effect on the collection of GST revenue, although it does on customs duty. If a registered business pays GST on an import of goods it is able to claim an input credit for that amount against its GST liabilities. Effectively, the GST not collected from registered businesses at the time of the importation is collected as part of any subsequent sales of goods or services.

### **Exemption from duty**

Customs By-laws, under the *Customs Tariff Act 1995*, apply the 'free' duty rate to a consignment of goods imported into Australia if the customs value does not exceed \$1000. The by-laws specifically exclude consignments containing tobacco, tobacco products, or alcoholic beverages, irrespective of value.

The amount of duty normally imposed on imports is based on the customs value of the goods and the tariff rate for those goods (see table 7.1 for examples). The customs value is usually the amount paid for the goods, converted to Australian currency at the exchange rate applicable on the day the goods were exported.

The rate of import duty varies depending on the tariff classification of the goods, whether any concessional rates apply and whether the goods are entitled to a free or reduced rate of duty under preferential trade agreements (box 7.2). The tariff rates and concessions are set out in the *Customs Tariff Act 1995* and the schedules to that Act. Most goods which are not free of duty are subject to a 5 per cent rate of tariff while clothing attracts a tariff of 10 per cent.

Because of the different rates applied to different goods, and the wide range of concessions, it is not possible to accurately estimate what the average rate of duty is on goods whose value is below the threshold, and therefore what the amount of duty forgone might be. In March 2011, Australia reported to the World Trade Organization's Trade Policy Review that over 46 per cent of all tariff lines are duty free. Of the lines that attract duty rates, 96 per cent are applied at a rate of 5 per cent or less. The average applied tariff rate is 2.9 per cent (WTO 2011a). However, this figure is a simple average which is not weighted to take into account the mix of goods being imported, or the preferential rates which apply to imports originating in some countries.

**Table 7.1 Examples of customs duty on imported goods**

<i>Goods</i>	<i>Duty rate</i>	<i>Exemptions</i>	<i>Schedule 3 Reference</i>
Books and magazine	Free		Chapter 49
Cameras and camera accessories	Free		Chapter 90
CDs and DVDs	Free		8523.40.00
<b>Toys</b>		Free: NZ, Papua New Guinea, Forum Island countries, developing countries, least developed countries, Singapore, United States, Thailand, Chile, AANZ countries	
Puzzles (other than puzzle books)	5%		9503.00.50
Electric trains and scale model kits	Free		9503.00.60
Construction sets	5%		9503.00.70
Toy musical instruments	Free		9503.00.40
<b>Sports equipment</b>		Free: NZ, Papua New Guinea, Forum Island countries, developing countries, least developed countries, Singapore, United States, Thailand, Chile, AANZ countries	
Skis	Free		9506.11.00
Ski-fastenings	Free		9506.12.00
Other ski equipment	5%		9506.12.00
Water-skis	5%		9506.29.00
Lawn-tennis balls	Free		9506.61.00
Golf balls	5%		9506.32.00
Bicycle parts (other than frames and forks)	Free		8714.92.00 – 8714.99.00
Bicycles, frames and forks	5%		8712.00.00, 8714.91.00
Compact disc players	5%	Free: NZ, Papua New Guinea, Forum Island countries, developing countries, least developed countries, Singapore, United States, Thailand, Chile, AANZ countries	8519.20.90
Footwear (other than some specialist footwear such as ski-boots and footwear for diving which are free)	5%	Free: NZ, Papua New Guinea, Forum Island countries, developing countries, least developed countries, Singapore, United States (certain goods are at a concessional rate until 1 January 2014), Thailand, Chile, AANZ countries	6401, 6402, 6403, 6404, 6405
Clothing – dresses, mens' suits, jeans	10% From 1 July 2015 rate falls to 5%	5% developing countries. Free: NZ, Papua New Guinea, Forum Island countries, least developed countries, Singapore, United States, Thailand, Chile, AANZ countries, and from 1 July 2015 developing countries	Chapter 62

Source: *Customs Tariff Act 1995*, Schedule 3.

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## Box 7.2 Preferential trade arrangements

Many goods originating in certain countries are free from duty or have special rates of duty applied, sometimes as a result of preferential trade agreements. Goods originating in the following countries may be free of duty or have lower than usual rates of duty:

- Canada
- Chile
- New Guinea
- New Zealand
- Singapore
- Thailand
- United States
- countries covered by the ASEAN - Australia - New Zealand Free Trade Area (AANZ countries) (New Zealand, Singapore, Myanmar, Brunei Darussalam, Vietnam, Malaysia, Philippines, Thailand, Indonesia, Laos and Cambodia)
- Forum Island countries (Cook islands, Fiji, Kiribati, Republic of Marshall Islands, Federated States of Micronesia, Nauru, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu)
- least developed countries (fifty countries including Afghanistan, Bangladesh, Cambodia, Maldives, Nepal and Uganda)
- developing countries (up to 87 countries, which may include Argentina, Brazil, China, Cyprus, Czech Republic, East Timor, India, Korea, Mexico, Turkey and Vietnam).

The rules for determining the country of origin of goods for which a preferential rate of duty is claimed are set out in Division 1A of Part VIII of the *Customs Act 1901*. The country of origin is generally the country where the goods were manufactured, not the last country through which the goods passed before arriving in Australia.

Source: *Customs Act 1901*; *Customs Tariff Act 1995*; World Customs Organization [http://www.wcoomd.org/home\\_cboverviewboxes\\_valelearningoncustomsvaluation\\_orinonpreferentialover viewchallenges.htm](http://www.wcoomd.org/home_cboverviewboxes_valelearningoncustomsvaluation_orinonpreferentialover viewchallenges.htm) (accessed 17 August 2011).

In 2009-10, Customs reported that the total amount of duty collected was \$5.7 billion while the amount of GST collected or deferred was \$21.9 billion (Customs 2010). This suggests that the amount of customs duty collected on imports was equivalent to about 26 per cent of the amount of GST. During its recent Enhanced Compliance Campaign on the low value threshold, Customs identified additional revenue comprising \$589 000 in GST payments or deferred GST, and an additional \$128 000 of duty (Customs 2011a). This suggests that the amount of duty

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which might be collected on parcels with a value near the current threshold is around 22 per cent of the amount of GST.

### **Lower reporting requirements**

Under section 68 of the *Customs Act 1901*, and the associated regulations, imported goods that have a value not exceeding \$1000 will not be subject to formal entry requirements. International mail parcels are only required to carry a CN22 or CN23 Customs Declaration (or equivalent). Low value goods carried by express carriers are documented through the electronic Self Assessed Clearance (SAC) process which requires a lower level of information and documentation than a full import declaration (FID).

### **Exemption from fees and charges**

Customs Integrated Cargo System Cost Recovery Charges and Australian Quarantine and Inspection Service (AQIS) Import Declaration Fees are imposed on consignments subject to a FID. The Customs charge for electronic entry of air and sea consignments which are entering through the FID process is \$40.20 per declaration. International Mail parcels valued at above \$1000 would usually pay the manual documentary charge for a FID of \$48.85 per declaration. The full schedule of customs charges are set out in Australian Customs Notice No. 2006/21.

AQIS also imposes a standard charge for each FID, and a range of other charges for specific AQIS activities such as goods inspections. The basic charge is \$15 for each FID declaration on an entry by air, and \$14 for each FID on an entry by sea (AQIS 2011). The standard charge only affects air and sea consignments valued at more than \$1000. There is normally no AQIS charge for postal items requiring a FID. These charges are currently collected through the Customs Integrated Cargo System (ICS).

### **Alignment of thresholds**

At present Australia applies the same \$1000 threshold to each of the four relevant areas: customs duty, GST, fees and charges, and level of reporting. However, the thresholds have not always been aligned. In the late 1990s different thresholds applied to the collection of duty and tax, to the requirement for a formal customs entry, and different thresholds applied to postal goods and other cargo.

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The existing nexus between these four areas need not necessarily be retained. Changing the threshold for the collection of GST, for example, does not necessarily mean that the threshold for collection of customs duty, for reporting requirements, or for the imposition of fees and charges, should be changed in the same manner. Other countries apply different thresholds to different areas.

### **7.3 Overseas indirect tax arrangements**

To inform discussion on this issue, the Commission has examined how mail processing and tax collection systems work in other countries. Most other countries have set thresholds below which they do not attempt to collect taxes. Some examples of threshold levels are set out in table F.1 (see appendix F). Many countries also have different, usually higher, thresholds for gifts.

The Commission has sought information on how other countries have approached the issue of setting a threshold. However, there is very little public information available. In considering the appropriate threshold it appears that some countries emphasise the economic costs and benefits of the threshold, while other countries place more emphasis on equity, law enforcement, or the protection of domestic industries. Where the costs and benefits are considered in determining the most appropriate threshold, the threshold may differ depending upon the administrative arrangements and duty and tax rates. In countries with low or no VAT/GST and low rates of duties, such as the United States, the threshold level at which the benefits of collecting revenue exceed the costs will usually be higher than in countries with high rates of tax and duty.

There are some international arrangements regarding thresholds. The thresholds applied by members of the European Union (EU) are guided by a Council Directive which requires each member to set a threshold within a limited range. These thresholds apply only to goods from outside the EU as the movement of goods within the EU is not subject to the collection of duty and taxes at the border. Asia-Pacific Economic Cooperation (APEC) officials have recently been instructed to develop a plan to identify ways to simplify customs procedures to ensure the wider implementation of commercially useful *de minimis* values.

The Commission has also sought information about methods of processing international mail parcels. While other countries have different approaches to the process, the initial sorting of international mail parcels in other jurisdictions generally appears to be a manual process, similar to that used in Australia. However, other countries have much more streamlined processes for assessing and

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collecting duty and taxes on international mail parcels with a value above the threshold.

## 7.4 Impact of the threshold on revenue

The current LVT in Australia has the effect of reducing the amount of both GST and duty collected. In the case of GST, the revenue collected is distributed to the states and territories after the Commonwealth's costs of collecting the revenue have been deducted. Provided that the cost of collecting revenue to the Commonwealth is less than the revenue collected, the states and territories will gain additional funds from lowering the threshold. However, for parcels of very low value the cost to the Commonwealth of collecting the revenue may exceed the revenue collected and lead to a reduction in the funds transferred to the state and territory governments. In this context the additional revenue collected arising from lowering the LVT includes not only the GST now collected on imports. Additional GST will be collected on goods sold by domestic retailers if some consumers switch back to domestic retailers as a result of the higher prices on imports. Also, other consumers may switch their spending from higher priced imports to other service industries where additional GST revenue will then be collected.

As customs duty flows to the Commonwealth any net customs duty revenue gained from lowering the threshold will flow to the Commonwealth.

Estimating the current and future impacts on revenue is not a straightforward process. Treasury has previously estimated that in 2010-11, the GST revenue forgone might be \$460 million, rising to \$610 million in 2013-14, although Treasury noted that the estimate reliability was 'low' (Treasury 2011). The Conference of Asia Pacific Express Carriers (CAPEC) has suggested the level of revenue forgone may be significantly lower at \$315 million (sub. 90).

A number of factors affect the calculation of the amount of revenue currently forgone and the possible impact of any changes to the threshold. The accuracy of any estimates will be affected by the reliability of data on the:

- number, value, and distribution of low value consignments entering Australia through international mail, air cargo and sea cargo
- rate of duty applicable to low value consignments
- value of consignments whose contents are GST exempt, addressed to businesses registered for GST, or to non-profit organisations exempt from GST

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- level of other costs (such as freight, insurance and customs duty) which may be included in calculations of the Value of Taxable Importation for calculation of GST
  - extent to which any change in the threshold may affect the behaviour of importers and alter the value of consignments entering Australia.

Unfortunately, much of the data needed for an accurate estimate of forgone revenue are either not available, or consists of estimates which may have a low level of reliability. While detailed information is available on the number and value of parcels entering Australia through air cargo, only limited data are available on the number and value of international mail parcels (the vast majority of parcels entering Australia).

The average rate of duty applicable to low value consignments is not known. As noted earlier, based on the total amount of customs duty and GST collected on imports, and the revenue collected during the customs compliance campaign when contraventions were detected, the amount of duty collected may be around 22-26 per cent of the amount of GST. The Centre of International Economics (CIE) has estimated that the average rate of duty applicable to low value imports is 3 per cent for imports to business and 5 per cent for imports to individuals (sub. 90).

There is little impact on GST revenue from the different treatment of parcels delivered to businesses registered for GST and non-profit bodies as they will yield no additional GST if the threshold were reduced to zero. CAPEC members sampled just under 70 000 low value consignments over a one week period and estimated the number and value of consignments being delivered to businesses and individuals based on the consignee name. The results of this sampling are set out in table 7.2.

These data indicate that a large proportion of lower value air cargo parcels are destined for business users and, as might be expected, a larger proportion of high value parcels are destined for businesses. The proportion of business parcels arriving through international mail will probably be lower, but there are no data on this.

Lowering the threshold is likely to result in a fall in the number of low value parcels brought into Australia by price sensitive consumers. This will affect the amount of additional revenue collected, but the extent of that change is unclear. The CIE has suggested that the demand elasticity could be around 1 (sub. 90, attachment 1).

**Table 7.2 Low value consignments for individuals and businesses**

<i>Value range</i>	<i>Consignment value</i>		<i>Consignment numbers</i>	
	<i>Business/other</i>	<i>Individual</i>	<i>Business/other</i>	<i>Individual</i>
\$	%	%	%	%
0-100	33.2	66.8	49.8	50.2
101-200	29.7	70.3	29.4	70.6
201-300	35.7	64.3	35.4	64.6
301-400	41.4	58.6	41.3	58.7
401-500	45.8	54.2	45.8	54.2
501-600	50.0	50.0	50.1	49.9
601-700	53.2	46.8	53.3	46.7
701-800	58.2	41.8	58.2	41.8
801-900	55.5	44.5	55.5	44.5
901-1000	59.5	40.5	59.4	40.6

Source: CAPEC (sub. 90, attachment 1, pp. 13-15).

The National Retail Association has suggested that there may be a much larger shift of retail spending to overseas retailers as a result of price differentials caused by the LVT. It has provided the Commission with overseas research which suggests that the elasticity could be large (Ellison and Ellison 2008). However, that research only examined a single product market within the United States, where price could be expected to be the most significant driver of consumers' decisions about where to buy the same product. In this case the results are likely to be different because, even when the products being considered for purchase, either online or from a local retailer, are identical, they are not perfect substitutes. Consumers considering buying goods online from overseas retailers do not have the opportunity to examine those goods in a store or take immediate delivery; the overseas online transaction entails high freight costs (whether explicit, or built into the purchase price in the case of 'free' delivery); and they may not be protected by Australian product safety standards, consumer laws or, in many cases, warranties. There is insufficient information to consider other than a very broad range of estimates of how elastic the demand for goods from overseas retailers might be to changes in the LVT, though it will clearly be different for different goods.

Reducing the threshold may also lead to other changes in behaviour, such as ordering larger quantities of goods in one consignment to spread the freight and administrative costs over a larger number of individual items, as there will be less opportunity to gain from importing small quantities.

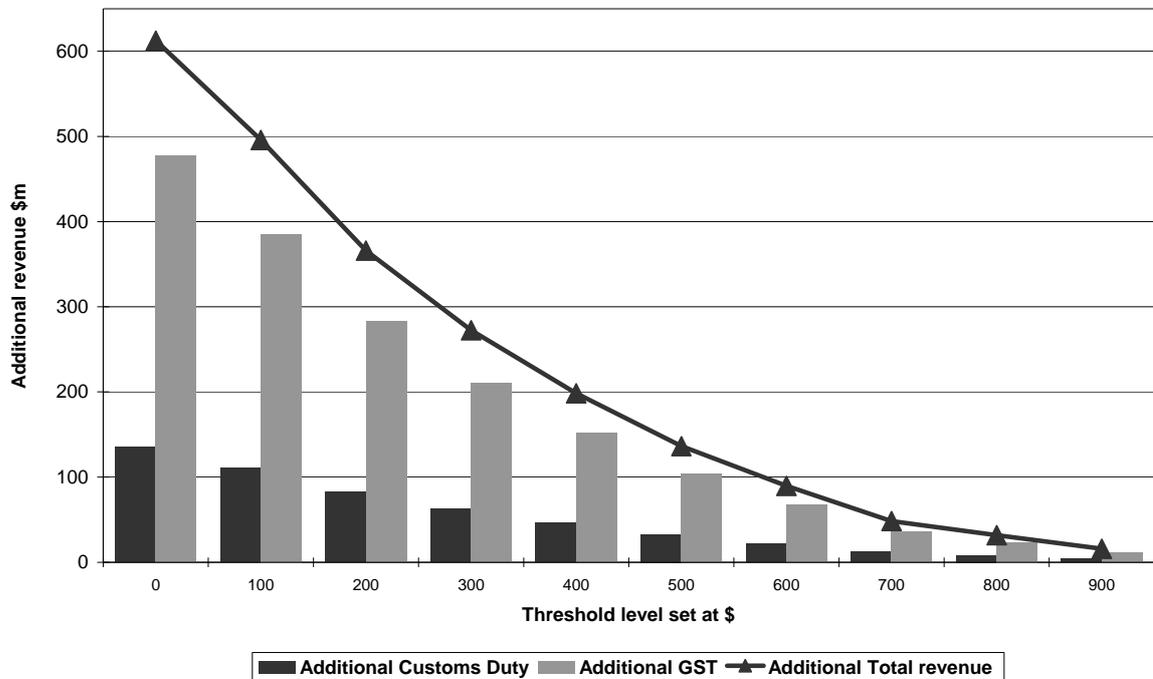
Having said that, a proportion of any fall in imports of low value consignments due to a change in the threshold is likely to be due to consumers switching to domestic channels for the same items. The goods sold through those domestic channels will

have had duty and GST paid on them when they were imported by domestic retailers, which ultimately will flow through to costs paid by the consumer.

The Commission has estimated that the additional revenue (ignoring collection costs and any behavioural changes) which might be collected if the threshold were abolished may be around \$480 million in GST and \$135 million in duty (see figure 7.1). However, these estimates are based on a large number of assumptions and should be treated as only providing a general guide to the revenue implications of changes to the threshold.

**Figure 7.1 Estimated additional gross revenue at lower threshold levels (excluding costs of collection)<sup>a</sup>**

For air cargo and international mail, 2010-11



<sup>a</sup> Assumptions: average value of international mail items in each value range is the same as the average value for air cargo; average rate of customs duty is 2.5 per cent; average cost of freight for air cargo is 30 per cent of parcel value; value of air cargo parcels delivered to GST registered businesses is as set out in table 7.2; 10 per cent of international mail parcels are delivered to GST registered businesses; no parcels contain goods exempt from GST or are addressed to exempt entities; the number and range distribution of international mail parcels is as estimated in table 7.3; the number, value and distribution of air cargo parcels is as set out in table 7.4; no adjustment has been made to account for elasticity of demand; sea cargo has not been included. Note that the figure only shows additional gross revenue, not the net revenue after deducting the costs of collection.

Data source: Commission estimate.

Any additional charges which might be collected by the Government from importers as a result of a change in the threshold would not represent additional net revenue. The charges are imposed on a cost recovery basis and represent a transfer

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of the general costs of border operations from the Government to importers. They do not generate any net revenue for the government.

In addition to any direct increase in the amount of revenue received by governments, a reduction in the threshold may be significant in protecting the tax base from erosion as overseas online retailing continues to grow.

## **7.5 Processing of parcels entering Australia**

Most of the parcels entering Australia with a value below the current threshold are entering as international mail. In 2009-10 over 36 million parcels entered through this avenue. During the same year just over eight million parcels entered Australia as air cargo consignments, usually being handled by the major express carrier businesses. A small number of parcels also entered Australia as sea cargo.

Parcels brought into Australia as international mail or by express couriers as air cargo enter Australia through distinctly different processes.

### **Processing of international mail**

The number of international mail parcels entering Australia has been growing rapidly over recent years. Australia Post (sub. DR192) has indicated that in the financial year 2010-11 the volume of inbound international parcels grew by 56%, compared with a growth rate of 28.1% for the previous financial year. However, the Commission has not received any data from Australia Post on the actual number of international mail parcels which have been received.

It has been estimated that there were over 36 million items of international mail imported in 2009-10 (Customs 2011d). Based on the growth in volume of air cargo parcels received during the 2010-11 financial year, compared with the previous year, the Commission estimates that the total number of international mail parcels for 2010-11 may be around 47.5 million. Table 7.3 shows an estimate of the number of international mail parcels in each value range entering Australia.

Most parcels are valued at less than \$100, but there are no comprehensive data on the average value of international mail parcels. In 2009-10, only about 20 000 (0.32 per cent) of all international mail parcels were valued at more than \$1000. Some data are available from limited sampling conducted by Customs.

**Table 7.3 Estimated number and value of international mail parcels entering Australia, 2010-11<sup>a</sup>**

<i>Value range</i>	<i>Percentage in range - lower estimate</i>	<i>Percentage in range - upper estimate</i>	<i>Estimated number of parcels in range</i>
\$			millions
0-100	68.59	75.16	34.85
101-200	12.85	12.95	6.26
201-300	4.85	6.11	2.66
301-400	2.45	3.73	1.50
401-500	1.61	2.34	0.96
501-600	1.17	1.18	0.57
601-700	0.88	0.89	0.43
701-800	0.02	0.37	0.09
801-900	0.02	0.26	0.07
901-1000	0.02	0.28	0.07
<b>Total</b>			<b>7.46</b>

<sup>a</sup> Columns do not total to 100 per cent. The estimate of the number of parcels is based on mid range percentage adjusted to total 100 per cent.

Sources: Customs (2011c); Productivity Commission estimate of likely total volume.

The distribution of parcels across the value ranges shown in table 7.3 is very similar to the distribution across value ranges of online overseas purchases, shown in chapter 4 (table 4.2). Nevertheless, not all of these parcels are online purchases. A significant number, for example, will be gifts, care packages, goods being sent home by travellers, or business documents.

Individual international mail parcels are not electronically documented or reported prior to their arrival. The parcels have a CN 22 or CN 23 Customs Declaration (see box 7.3 and box 7.4) attached which identifies the sender and recipient, gives a brief description of the contents, their value, and whether the item is a gift. The CN 22 and CN 23 Customs Declaration is an agreed international document.

Due to the number of parcels arriving, Customs is not equipped to assess value for all mail articles. It employs a risk-based approach, whereby Customs arranges to be present only for a proportion of mail articles assessed as most likely to contain border risks. This includes identifying goods above \$1000 and for other revenue and border risks (Customs 2011c).

Identifying articles for revenue liability is an intensive physical process that requires manual checking of each article. If the value of the parcel is over \$1000, Customs refers the item to Australia Post which inputs details into its own system and sends the addressee a First Notice advising them of the need to complete a Full Import Declaration (FID). Upon receipt of the completed paper FID, Customs manually

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enters the information into its Integrated Cargo System (ICS), calculates the liabilities due, and sends the addressee a notice to pay the duty, GST, and a cost recovery charge of \$48.85. Once payment has been received by Customs, the parcel is released for delivery. While this process is underway, Australia Post retains possession of the parcel. Secure storage of these parcels is occupying increasing space in international mail gateways.

This is an inefficient process. While it may have been adequate when parcel volumes were much lower, it needs to be streamlined regardless of what changes may be made to the threshold.

FIDs were originally designed for use by third party service providers in the air and sea cargo streams, and are predominately reported to Customs electronically through the ICS. But for International Mail parcels:

Customs and Border Protection has designed a manual FID that can be used in the postal stream by importers, however, they often experience challenges identifying the required tariff codes. As a result, this often leads to importers contacting Customs and Border Protection for assistance in completing the manual declaration. Any increases in the current number of manual FIDs being lodged would likely lead to an increase in enquiries. While the small numbers makes this achievable at the moment, increases would require a change to the existing process and manual FID (while ensuring alignment in requirements across import streams). (Customs 2011c, p. 3)

### **Box 7.3 Universal Postal Union**

The Universal Postal Union (UPU) was established in 1874 and currently has 191 member countries. It became a specialised agency of the United Nations in 1948.

The UPU is the primary forum for setting the rules of international co-operation between national postal authorities. For example, the UPU:

- sets standards for the size of postal items. For instance the UPU regards a parcel as a postal item weighing more than 2kg. (Australia Post refers to items less than 20 mm thick and weighing less than 500g as a larger letter; items larger than this are generally described in Australia as parcels. This is the definition used in this report.)
- sets standards for the addressing of postal items
- sets standards for CN 22 and CN 23 Customs Declarations carried on postal items travelling between countries
- sets terminal dues and transit charges for mail travelling between different countries
- promotes cooperation on technical issues and the development of new technology.

Source: Universal Postal Union, <http://auspost.com.au/annualreport2010/parcels-and-logistics/>, (accessed 31 October 2011).

**Box 7.4 CN 23 Customs Declaration**

**CP 00 707 599 2 NO**



No(s) of parcel(s)  
(barcode, if any)

**CN 23 CUSTOMS DECLARATION**

(Designated operator)		Sender's Customs reference (if any)		
<p><b>From</b></p> <p>Name _____</p> <p>Business _____</p> <p>Street _____</p> <p>Postcode _____ City _____</p> <p>Country _____</p> <p>Name _____</p> <p>Business _____</p> <p>Street _____</p> <p>Postcode _____ City _____</p> <p>Country _____</p>	<p>No(s) of parcel(s) (barcode, if any)</p> <p>Importer's reference (if any) (tax code/VAT No./importer code) (optional)</p> <p>Importer's telephone/fax/e-mail (if known)</p>			
<p><b>To</b></p> <p>Name _____</p> <p>Business _____</p> <p>Street _____</p> <p>Postcode _____ City _____</p> <p>Country _____</p>	<p>Quantity (2)</p> <p>_____</p>	<p>Net weight (in kg) (3)</p> <p>_____</p>	<p>Value (5)</p> <p>_____</p>	
<p>Detailed description of contents (1)</p> <p>_____</p>		<p>Country of origin of goods (8)</p> <p>_____</p>		
<p>Please indicate service required (tick one box)</p> <p>International Priority <input type="checkbox"/> International Economy <input type="checkbox"/></p> <p>Category of item (10)</p> <p>Gift <input type="checkbox"/> Commercial sample <input type="checkbox"/> Returned goods <input type="checkbox"/> Other <input type="checkbox"/></p> <p>Documents _____</p> <p>Comments (11): (eg: goods subject to quarantine, sanitary/phytosanitary inspection or other restrictions)</p>		<p>For commercial senders only</p> <p>HS tariff number (7)</p> <p>_____</p>		
<p>Explanations:</p> <p>_____</p>		<p>Office of origin/Date of posting</p> <p>_____</p>		
<p>Number of parcels _____</p> <p>Insured value SDR _____</p> <p>Total gross weight of the parcel(s) _____</p> <p>Charges _____</p>		<p>Postal charges/Fees (9)</p> <p>_____</p>		
<p>International Licence (12) _____</p> <p>Invoice number _____</p> <p>Certificate number(s) _____</p> <p>Invoice number _____</p>		<p>Total gross weight of the parcel(s)</p> <p>_____</p>		
<p>I certify that the particulars given in this customs declaration are correct and that this item does not contain any dangerous article prohibited by legislation or by postal or customs regulations</p>		<p>Date and sender's signature (15)</p> <p>_____</p>		

Parcels, 24th Congress 2008, art RC 122.2 – Size 204 x 144 mm (basic format A5) with a tolerance of 2 mm

Source: Universal Postal Union, Parcel Post Manual, p. F.8

## Air Cargo

In 2009-10, just over 8 million air cargo consignments valued at less than \$1000 entered Australia. The majority of these consignments were carried by the major express carrier (courier) businesses DHL, TNT, FedEx and UPS. In the 2010-2011 financial year the number of parcels rose to 10.6 million (table 7.4).

**Table 7.4 Air cargo consignments for July 2010 to June 2011**

Consignments with a value of less than \$1000

<i>Value range</i>	<i>Number</i>	<i>Per cent of air cargo valued at &lt; \$1000</i>	<i>Total declared value</i>	<i>Per cent of total value</i>	<i>Average value</i>
\$		%	\$	%	\$
0-100	7 206 897	68.1	171 389 203	13.3	23.78
101-200	1 378 728	13.0	199 540 094	15.4	144.73
201-300	633 720	6.0	155 481 616	12.0	245.35
301-400	366 328	3.5	127 333 699	9.9	347.68
401-500	266 221	2.5	119 763 577	9.2	449.87
501-600	197 217	1.9	108 154 880	8.4	548.41
601-700	154 594	1.5	100 355 453	7.8	649.15
701-800	134 940	1.3	101 237 677	7.8	750.24
801-900	128 737	1.2	109 833 503	8.5	853.16
901-1000	105 379	1.0	99 779 148	7.7	946.86
<b>Total</b>	<b>10 572 671</b>	<b>100.0</b>	<b>1 292 868 850</b>	<b>100.0</b>	<b>122.28</b>

Source: Customs (2011a).

The figures in table 7.4 only represent air cargo consignments valued at below the \$1000 threshold. While there are very few international mail items with a value above the threshold, the proportion of air cargo consignments of higher value is much more significant (table 7.5).

All air cargo parcels with a value less than the threshold must be declared to Customs on a Self Assessed Clearance (SAC) lodged electronically with Customs. The carriers collect information about the sender, receiver, type of goods and value when accepting the parcel for delivery. The SAC is filed electronically by the importer (usually the express carrier for small items) and forms the basis of further reporting to Customs. Customs is notified in advance of the arrival of the parcel. This allows Customs and AQIS to carry out a risk assessment on the parcel while it is in transit.

**Table 7.5 Air cargo consignments for July 2010 to March 2011**

Consignments with a value between \$1001 and \$5000

<i>Value range</i>	<i>Number of consignments</i>	<i>Total declared value</i>
\$		\$
1001 – 1100	33 793	35 389 115
1101 – 1200	29 480	33 896 835
1201 – 1300	26 972	33 679 845
1301 – 1400	25 040	33 801 924
1401 – 1500	23 426	33 985 815
1501 – 5000	321 323	882 081 710
<b>Total</b>	<b>460 034</b>	<b>1 052 835 244</b>

*Source:* Customs (2011c).

Upon arrival in Australia the parcels are physically checked and screened as required. If there are no issues requiring further action, they are released for delivery.

For air cargo consignments with a value above the threshold, the carriers collect additional information when the parcel is lodged. This information is used by customs brokers employed by the express couriers to identify the tariff code and make a FID.

The fee for Customs clearance of air freight entering through a FID is \$40.20. AQIS also imposes a \$15 Import Declaration Fee for each FID in relation to consignments entering by air. If a parcel has been sent by one of their account holders, the express carriers will usually deliver the parcel and add any taxes and charges to the account. The express carriers may impose a charge for providing this service. Where there is no account, the taxes and charges are collected before delivery of the parcel.

### *Sea Cargo*

The number of low value consignments entering Australia by sea is small, as the majority of sea cargo consignments are in excess of the low value threshold. In 2009-10 sea cargo accounted for 47 369 low value consignments. This represents approximately 0.1 per cent of the number of low value air cargo and mail parcels. The number of sea cargo consignments in this category has increased somewhat in the last year: from July 2010 to March 2011 there were 55 356 low value sea cargo consignments. These consignments are also processed through the SAC process. In the same period, a further 105 454 sea cargo consignments with a value of between \$1001 and \$5000 entered Australia (Customs 2011c).

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## 7.6 Economic principles

A fundamental principle and objective of tax policy is to raise revenue in a manner that minimises the cost to the community. Generally, the more broadly based a tax the lower will be the ‘excess burden’ of raising a dollar of revenue — that is, the cost of distortions and compliance in addition to the loss of a dollar transferred to government. This is not only because of the potential for economies of scale in administration and collection but also because there is less scope for people to change their production or consumption decisions to avoid the tax (which results in inefficiency). Conversely, the application of taxes to some transactions but not others has the potential to distort the market. This could lead to distortions in resource allocation, losses in efficiency, and a consequent reduction in community welfare. A low value threshold for imports can be seen as operating as a negative tariff for the domestic retail industry and their suppliers. In the case of the GST it would be consistent with the principle of minimising distortions in resource allocation to apply the same rate of taxes and duty to all imports so that competing businesses were treated equally.

That is, the LVT for imported goods introduces inefficiency into the GST base. While currently there appears to be little evidence of significant compliance problems with imported goods, the absence of taxes on LVT transactions will distort the prices consumers face and may give them an incentive to bring in goods in small quantities or break up larger items into several transactions. The LVT will also provide consumers with an incentive, to reduce their consumption of the services provided by local bricks and mortar and domestic on-line retail outlets. Removal of such inefficiency, of itself, would generate welfare gains to the community

Customs duties on the other hand are taxes on consumers and businesses which purchase foreign goods. Unlike the GST, which is a broad based consumption tax which is intended to minimise distortions, one of the main roles of customs duty has been to create distortions which favour domestic business over overseas business. The low value threshold with respect to customs duty undermines the protective effect of the tariff assistance provided to industries where duty is applicable. Again, however, the negative effect of the threshold on industry needs to be weighed against the benefits consumers receive from lower prices of goods (that is an increase in consumer surplus) due to the exemption from taxes and associated collection costs and, on the other hand, the administrative and compliance costs of collection were the LVT to be lowered.

Notwithstanding the potential for inefficiency from non-neutral taxation of substitutable transactions, the costs of collecting taxes which are borne by

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government, business and consumers entail efficiency losses and are part of the deadweight loss for the community. Therefore, from the viewpoint of maximising the welfare of all Australians, the question is whether there are likely to be bigger losses in welfare from trying to provide equal treatment by collecting taxes on all imports, than from the distortions created by differential rates of tax and duty for overseas and domestic retailers.

As the recent Henry Tax Review noted:

Related to the issue of complexity are the costs of administering and complying with the tax and transfer system. These costs represent a net loss to the economy, because the resources engaged in these activities could otherwise be put to more highly valued uses. Recent research suggests there is an optimal level of system complexity and operating costs, one that balances administration and compliance costs with improved efficiency and distributional outcomes. (Henry 2009, p. 21)

Many taxes provide for exemptions, or simplified arrangements, when the costs of administration and compliance are high in relation to the amount of revenue which might be collected. For example; small businesses with a turnover of less than \$75 000 are not required to register for GST; many small businesses, including retailers, are not required to register for payroll tax; and the income tax system provides a number of concessions for small business such as simplified treatment of depreciating assets. The effect is that competing businesses are treated differently depending upon their size or how they are structured. These provisions reduce government revenue and may cause distortions in resource allocation, but are generally considered justified because they reduce the deadweight costs to the community of administration and compliance.

In 1985 the Industries Assistance Commission (IAC) was asked to inquire into the passenger concessions under which some goods brought into Australia by travellers were allowed to enter free of duty and sales tax. In its report the IAC noted that ‘passenger concessions have adverse effects on public revenue, change the pattern of resource use and are inequitable’ (IAC 1985, p. 65). Nevertheless the IAC took into account the impact on the flow of passengers through airports and recommended a duty free limit of \$1000:

It recommends that if the Government wishes to achieve, on average, an unimpeded flow of 90% of Australian residents through the Customs barrier, together with a restriction on usage (once every three months) and a review at lengthy intervals (say every 5 years), the limit be set at \$1000. (IAC 1985, p. 7)

A reduction in the LVT would contribute towards an improvement to the welfare of the community by removing the current distortion in resource allocation arising from the differential treatment of Australian and overseas retailers. The extent of that benefit is difficult to determine, as it depends on the willingness of consumers

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to substitute direct foreign purchases for domestic sources. The Commission estimates that even if consumers regarded the two modes as highly substitutable for all goods purchased (which, for reasons outlined earlier, is highly improbable), the efficiency benefit from removing non-neutral tax treatment would be in the order of \$70 million per year. Allowing for a moderate degree of substitutability puts the annual cost at around \$10 million (appendix H). While not insignificant, these costs must be weighed against the costs incurred collecting the tax on LVT purchases.

On behalf of eBay Australia, the Allen Consulting Group conducted a broader analysis of the impact of lowering the GST low value import threshold from the current value of \$1000 to \$250. The modelling was based on a computable general equilibrium framework using the Monash Multi Regional Forecasting Model. The modelling showed that lowering the threshold would lead to reductions in GDP, consumption, exports, imports and employment. The changes predicted were not large, with GDP expected to decline by \$20 million. The results suggested that there would be a slight negative impact on employment and that the reduction in the threshold would act like a tariff with an increase in production in some industries, such as manufacturing, being more than offset by a decline in the output of other industries, including retailing (eBay Australia, sub. 101).

An examination of the broad effect of changing the de minimis in the United States has also concluded that the benefits of a high threshold outweigh the costs. A paper recently submitted by the United States to APEC stated that raising the de minimis threshold for shipments entering the United States from US\$200 to US\$800 would produce net benefits to the United States.

While a higher de minimis exemption might reduce government revenue, it will also cut overall compliance costs, reduce delivery times, and encourage low value imports, especially direct purchases by consumers and small business firms from overseas suppliers. We estimate that the annual net gain from raising the de minimis threshold on the existing volume of US shipments would be about \$26 million, taking into account the cost savings to all affected parties – customers, express firms and U.S. Customs and Border Protection (CBP). In other words, the loss of tariff revenue and fees would be more than offset by the savings to the multiple parties in the delivery chain. (Hufbauer and Wong 2011, p. 1)

It would also be undesirable for entry processes to become an impediment to trade. Competition from international retailers can be important in driving efficiency in the Australian retail industry. In addition many businesses currently receive goods which enter Australia under the LVT. Longer delays or unnecessary charges associated with processing such imports will hinder those businesses and there will be very limited additional revenue collected, as discussed later.

Table 7.6 shows the combined impact of the current taxes and processing charges on the cost of importing goods into Australia by international mail. For goods with a value below \$100 (which comprise almost one quarter of all goods entering under the LVT) taxes and charges will of course represent a higher share of their value. Moreover, these data are likely to underestimate the full cost as they have not taken into account freight charges in the value on which GST is calculated, and do not include any estimate of the administrative costs of completing a FID.

**Table 7.6 Taxes and charges as a percentage of value of goods**  
International mail parcels

<i>Value of Goods</i>	<i>Manual Import Processing charge</i>	<i>GST and duty (5 per cent) GST (10 per cent)</i>	<i>Total taxes and charges</i>	<i>Total as a percentage of value</i>
\$	\$	\$	\$	%
100	48.85	15.00	63.85	64
200	48.85	30.00	78.85	39
300	48.85	45.00	93.85	31
400	48.85	60.00	108.85	27
500	48.85	75.00	123.85	25
600	48.85	90.00	138.85	23
700	48.85	105.00	153.85	22
800	48.85	120.00	168.85	21
900	48.85	135.00	183.85	20
1000	48.85	150.00	198.85	20

Source: Customs (2011c, p. 9).

## 7.7 Impact of the threshold arrangements

### Impact on the retail industry

The application of a low value importation threshold has an effect on the domestic retail industry. Because of the growth of online overseas purchases via the internet some domestic retailers are now having to compete with overseas retailers. The LVT contributes to a price differential so that consumers sometimes find that it is cheaper to buy goods online from overseas retailers than through domestic retailers (see chapter 6). Domestic retailers claim that the price differential contributed to by the threshold leads to:

- a reduction in turnover for domestic retailers

- 
- reduced profitability of domestic retailers
  - loss of employment with domestic retailers.

The immediate effect of a threshold is to reduce the cost to consumers of buying goods from overseas retailers. By exempting many parcels from customs duty and GST, overseas retailers benefit from a cost advantage of 10-20 per cent over domestic retailers who are paying duty (where applicable) and GST on their stock (National Retail Association, sub. 102).

In a survey conducted by the National Retail Association (NRA) over half of the respondents estimated their consequent loss of sales to be over 20 per cent of their turnover (sub. 102). The loss in turnover can be significant for a business in that a reduction of '10-20% of your turnover does not take 10-20% of your profit it sometimes takes 50-100% of your net profit' (Wholesale Diving Supplies, sub. 59, p. 4).

While some retailers and industry organisations have raised strong concerns about the impact of the threshold on the level of online overseas shopping, others have placed more emphasis on other factors. The National Association of Retail Grocers of Australia says that 'the problems experienced by the industry in relation to lower priced goods coming in from internet based overseas suppliers is in part due to poor competition in local markets resulting from higher level of market concentration in many retail sectors' (sub. 124, p. 6).

Assessing the impact of the threshold on the competitiveness of the Australian retail industry, and therefore the likely impact of any change to the current arrangements, is not simple. As discussed in the previous chapter there are a number of factors which appear to be driving the growth of online retailing in general and which affect the relative competitiveness of domestic and overseas retailers. Moreover, not all of the parcels entering under the threshold are consumer or business purchases.

Further, there are natural barriers which make it more difficult for overseas retailers to compete for customers in Australia. Large importers, such as retailers, often enjoy the benefits of buying in bulk and paying wholesale prices. They also pay significantly lower unit freight costs than a consumer ordering one item and receiving it by post or express courier. For example, the standard rate for sending a 1lb (454 gram) parcel from the United States to Australia by one express courier is US\$72.25 (A\$67), or about 55 per cent of the value of the average air cargo parcel (DHL 2011).

Postal services are less expensive. Sending a Priority Mail International Small Flat Rate Box from the United States to Australia costs US\$13.25 (\$A12) while a

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medium box costs US\$43.23 (\$A40) (United States Postal Service 2011). The Commission estimates, based on limited data, that the average value of mail parcels entering under the threshold may be around \$87.<sup>2</sup> On this basis, the cost of postage from the United States may be 15-46 per cent of the value of the average parcel. The cost of freight on small parcels can significantly outweigh any competitive advantage that overseas retailers enjoy as a result of the threshold. Moreover, Australian retailers are able to offer better consumer protection, warranty, and support services.

While the low value threshold contributes to the price differentials which are affecting domestic retailers it is not the only cause of such price differences, and should not distract attention from more critical long term issues affecting the competitiveness of Australian retailers (see chapter 4).

### *Enforcement issues*

Retailers have also been concerned that they are suffering additional harm because the threshold is being abused by overseas online retailers (ASGA 2010; NRA, sub. 102). During the first three months of 2011, Customs conducted an Enhanced Compliance Campaign to ensure that GST and customs duty concessions for low value imports were not being abused or exploited (Customs 2011a).

The results of the compliance campaign do not support the contention that there are high levels of non-compliance with the current threshold. The level of non-compliance identified in relation to international mail parcels was around 0.1 per cent while for air cargo parcels it was higher at 2.2 per cent. The usual targeted compliance activity by Customs, which continued during the campaign period, identified higher levels of non-compliance: 9.1 per cent for air cargo parcels and 3.2 per cent for international mail parcels in the target higher risk categories. While instances of underreporting of value and consignment splitting were found, there is little evidence of a significant compliance problem.

The Australia Sporting Goods Association is also concerned that goods are being imported, taking advantage of the threshold, and then sold online in Australia without the sales being reported through the tax system. The ATO is currently engaged in an online data matching program using data from eBay Australia and Trading Post Australia to assess the level of taxation compliance by online sellers of goods and services. The data are used to identify individuals and businesses who are:

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<sup>2</sup> Based on the estimated distribution of international mail parcels across value ranges, and the average value in each range for air cargo consignments.

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- participating in the cash economy
  - non-compliant with registration requirements
  - not reporting or under reporting sales
  - not meeting their lodgement and payment obligations under tax law (ATO 2011).

## **Costs to governments of collecting revenue**

The information available on the cost of collecting revenue on lower value consignments is limited. Customs has indicated that the integrated nature of the processing of international mail makes it difficult to attribute a specific cost to the identification of revenue liability. This occurs as part of Custom's broader targeting for a range of border protection risks including the identification of illegal goods such as illicit drugs, medicines, pornography, weapons and quarantine risks, with a view to preventing these items from entering Australia.

Customs states that its overall activity in international mail is delivered at an approximate cost of \$19 million (Customs 2011c). This is predominately an employee related cost, excluding technologies such as x-ray examination. It does not include the costs to Australia Post or the express carriers of housing Custom's activities within their facilities and so does not represent the full cost of Custom's activities.

At present, the Commission has not been provided with an estimate of the incremental cost to governments of collecting customs duty and GST on parcels. When the charges were last amended in 2005, in response to the change to the threshold, the explanatory statement to the regulations said that:

One result of this change is that the number of import declarations and warehouse declarations is expected to decrease over current and forward years, and hence the amount of import processing charges collected is also expected to decrease. Consequently, the increases in charges are to address the projected revenue shortfall and restore full cost recovery in accordance with the Australian Government Cost Recovery Guidelines. (Import Processing Charges Regulations 2006, Select Legislative Instrument 2006 No 82, Explanatory Statement)

Customs has advised the Commission that 'the International Processing Charge (IPC) is a notional recovery of the cost elements of border processing' (Customs 2011c, p. 8). Thus the import processing charge does not provide a guide to the incremental cost of processing an individual parcel for the sole purpose of collecting revenue. Rather, it represents a transfer from the government to importers of some of the administrative costs of processing imports.

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Customs has estimated that, once an international mail item has been identified for revenue purposes, manually processing a FID takes up to 45 minutes. This would represent about \$20.63 in labour costs based on average hourly cash earnings for clerical and administrative workers (ABS 2010d). There would also be additional costs from overheads. The additional cost to Customs from processing more air cargo parcels for revenue purposes would be much lower as the additional data collection and entry is performed by the express carriers. By comparison New Zealand Customs estimated that it takes an average of 20-30 minutes of officer time to process a Private Import Declaration at a cost of about NZ\$26.00 (\$A20) comprised of NZ\$18.50 (A\$14) in labour costs with overheads of NZ\$7.50 (A\$6) on average (New Zealand Customs Service 2011a).

As AQIS activities do not relate to the collection of revenue, there should be minimal changes to the cost to AQIS if more parcels are processed for revenue purposes. Nevertheless, AQIS processes are likely to be affected by any change to the existing procedures.

The costs of collecting this revenue represents a deadweight loss for Australians. The administrative and compliance costs, to all parties, of collecting the revenue diverts resources from more productive activities. The relative efficiency with which taxes are collected can have an impact on the broader Australian economy. As an example of collection costs to the Government in other areas, in 2009-10 the ATO reported net GST cash collection of \$44.1 billion. The states compensate the Commonwealth for the costs incurred by the ATO and Customs in administering the GST. In 2010-11 those costs were \$598 million, or approximately 1.4 per cent of the net revenue collected (ATO 2010a).

### **Impact on Customs processes**

Customs has raised issues about the ability of its existing infrastructure to cope with any increased processing. During 2009-10 around 20 000 international mail items entered Australia through a FID. Any reduction in the threshold would significantly increase the number of items being processed. On the Commission's estimate of the number of mail parcels likely to have arrived in 2010-11, reducing the threshold to \$700 may involve an increase in the number of mail parcels on which GST and revenue will have to be collected to around 240 000. Lowering it further to \$500 would increase the number to around 1.2 million parcels.

Customs has indicated that the ICS has been designed to manage transaction volumes in line with the current entry threshold, with reserve capacity to deal with the expected increased volumes of imported goods over its working life. A change

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to the threshold would require system capacity upgrades to reflect a new threshold as hundreds of thousands, or millions, of new declarations would be introduced, and each of these must be validated and processed. It noted that any variations to the threshold that impact on systems performance could reduce the efficiency of cargo logistics operations by slowing down cargo clearance times. Similarly a reduced threshold would result in many clients previously unaffected by duty and GST matters being required to meet the more complex issues of formal declarations (such as classification and valuation) for the first time. This would lead to an increase in requests for assistance from the Customs Information & Support Centre (Customs 2011c).

## **Costs to carriers**

### *Australia Post*

The collection of duty and GST on parcels also imposes costs on the carriers of those parcels. As described above, international mail parcels are processed by Customs and AQIS in Australia Post's four international gateways.

Australia Post is required to make floor space and equipment available to Customs and AQIS in its facilities. If parcels are opened by Customs or AQIS, international agreements require Australia Post staff to be present. Parcels which are being investigated, or on which revenue is being collected, are stored by Australia Post. Australia Post is involved in the process of contacting addressees who need to complete a full Customs clearance. Australia Post also pays fees to AQIS and, under some circumstances, may be required to meet some of Customs costs.

Australia Post also has to deal with any parcels which cannot be delivered, or where the addressee refuses to pay taxes and charges. This is likely to become a more significant issue if the threshold is lowered and the costs to addressees are a greater proportion of a parcels value.

At present Australia Post must absorb these costs. The Commission understands that international arrangements under the Universal Postal Union would make it difficult for Australia Post to recover any additional costs from senders or overseas postal administrations. Australia Post has noted that the terminal dues it receives from other postal administrations are well below the cost of delivery within Australia. It estimates that in the financial years 2010-2012 it will make a loss of \$1.06 per inbound international airmail packet (parcel of less than 2 kilograms) (sub. 120). The Commission has not received any information about the incremental

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cost to Australia Post if more parcels were above the threshold as a consequence of lowering the LVT.

### *Express Carriers*

The costs to express carriers are different to those of Australia Post. As described above, the express carriers capture much more information about parcels when they are lodged. The express carriers have end to end responsibility for the carriage of parcels and are therefore able to build any changes to compliance costs into their freight charges. They also employ their own customs brokers and are able to complete the processing of a FID in house on behalf of the consignee.

Express carriers would face additional costs if a larger proportion of the parcels they were carrying were required to be entered through a FID rather than as SACs. CAPEC identified the range of possible additional costs as including:

- additional time for brokers and classifiers. About 10 to 15 minutes is required for each formal declaration. Hourly rates for brokers and classifiers are typically \$60 to \$80 per hour
- additional time for administrative support staff
- additional costs for invoicing
- additional storage space for consignments (as formal declaration items are held for longer than those processed through SACs)
- on-costs such as building space, computer equipment etc.

CIE has estimated that CAPEC members would need to employ an additional 785 staff if the threshold were reduced to zero. It estimates that the additional costs to express carriers would be, conservatively, \$30 per consignment (sub. 90, attachment 1).

### **Costs to other businesses**

Businesses face significant costs from importing goods with a value over the threshold. The FID process takes longer to complete than the SAC or normal international mail processes, and entails additional costs through government charges and taxes. Businesses also have to meet the administrative costs of completing a FID either internally, through engaging a customs broker, or through their express carrier. The charges for employing a customs broker vary but CAPEC has indicated that the cost of engaging a customs broker ranges from upwards of \$50 for each consignment (sub. 90, attachment 1). Customs estimates that the

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charge is likely to be up to \$100 per parcel (Customs 2011c). In the 2008-09 financial year, 32 per cent of all postal declarations by businesses and consumers were lodged by customs brokers (Customs 2009).

While there is usually little difference in the cost of GST to a registered business under the two processes, there may be a change in the timing with some businesses being required to pay part of the GST at the time of importation (as well as duty) rather than following the final sale. Significantly, there will be additional compliance costs to GST registered businesses, even though they will, in effect, only be paying duty as there is no more GST being collected.

While businesses face costs from complying with all of their taxation obligations, the likely compliance cost to business from importing lower value parcels, under a reduced LVT, would probably be significantly higher than for other transactions. For comparison, it would be useful to consider the compliance costs of other areas of taxation. Unfortunately, there is limited information available on the cost to the community of compliance with tax systems. The Henry Review (Australia's Future Tax System) noted that the only available studies on the compliance costs of personal and business taxpayers in Australia dated from the 1990s and estimated that overall compliance cost were from 7 to 12 percent of the tax revenue raised (Henry 2008). The Henry Review reported that:

There has been no comprehensive quantitative study of GST compliance costs in Australia. A study of compliance costs in the UK suggests that VAT compliance costs decrease as a proportion of sales as sales increase, with compliance costs ranging from 0.003 per cent of taxable sales for large businesses to almost 2 per cent for small businesses (Sandford et al. 1989, p. 116). Estimates of compliance costs under a VAT system as reported by the United States Government Accountability Office (2008, p. 16) suggest that small business with sales under \$50,000 face a cost of compliance of 2 per cent of annual sales, compared with 0.04 per cent for businesses with sales over \$1 million. (Henry 2009, vol. 2, p. 288)

Slemrod (2010), commenting on US income taxes, indicated that the best estimate of compliance costs was 10 per cent of the revenue raised. Based on the limited and imperfect evidence available, it would appear that the total costs of compliance and administration (as discussed earlier) for other taxes are probably around 8-13 per cent of the revenue raised.

Moreover, businesses importing goods through a full import declaration face the cost of having capital tied up in undelivered parcels, costs flowing from possible customer dissatisfaction with delays, and possibly costs from production processes being delayed while goods are being cleared. These costs are difficult to quantify. In a paper examining the United States experience with low value imports, Hufbauer and Wong (2011) applied a time cost to purchasers of 0.4 per cent of the declared

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value of an entry for each day of delay. Applying this to a parcel valued at \$122 (the average value of air cargo consignments valued at less than \$1000) entry of which was delayed for two days would produce an estimated cost of delay to the receiving business of just under \$1. During 2009-10 the total value of air cargo consignments entering Australia was \$874 million. The cost of delay for two days for this total value of consignments would be around \$7 million using the methodology of Hufbauer and Wong (2011).

### **Costs to consumers**

Consumers in Australia face higher costs for items with a value above the threshold than for those below it. The FID process takes longer to complete than the SAC process or the processing of other international mail parcels, and entails additional costs through government charges on top of the cost of taxes. Consumers also have to meet the costs of completing a FID. On low value items these imposts could add a cost well in excess of the value of the item being imported.

The FID process requires the importer to provide information about the tariff classification of the goods and the statistical code. The Commission understands that few consumers are able to complete forms for this process without seeking assistance from Customs or engaging a customs broker. Customs has said that ‘for goods valued above the threshold, the vast majority of importers use the services of a customs broker or agent to expedite the clearance process, as it requires a relatively detailed knowledge of Customs procedures and systems, and knowledge of tariff classification applicable to a variety of goods’ (Customs 2011c, p. 1).

The costs to consumers of delays in receiving parcels and of completing forms or locating a customs broker to complete the process for them are difficult to estimate. However, these costs are potentially significant. Threshold arrangements may also have an impact on how readily consumers can obtain goods which are not generally available in their area.

## **7.8 Changing the threshold**

The exact cost of collecting revenue on each additional parcel under the current arrangements is difficult to estimate because of the lack of data. Using the Customs processing charges as a crude, lower bound proxy for all costs (and ignoring the possible need to engage a customs broker) provides one approach to estimating the costs and benefits of a change to the LVT. For example, reducing the threshold to \$100 would raise roughly \$500 million from about 16 million parcels (assuming no

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change in volumes as a consequence of consumers having to pay additional taxes and collection costs). But, based on the current customs processing charges, this would cost consumers and businesses approximately \$750 million.

However, actual processing costs are likely to be considerably higher. For an international mail parcel it could be around \$30 for the Government (made up of \$20.63 labour plus Customs overheads), \$10 for Australia Post (Commission estimate of costs from entering data, contacting addressees and storing parcels), \$50 to the addressee (the minimum cost of engaging a customs broker to complete the FID), and possibly \$2 for the delay in receiving the parcel. The cost to the community of processing each additional International Mail consignment under the current arrangements could therefore be around \$90.

Based on the data available and the Commission's estimates for 2010-11, reducing the current threshold for the collection of duty and GST to \$100 while utilising the current processing system might:

- bring an additional 12.6 million international mail parcels and 3.4 million air cargo parcels into the revenue stream
- generate an estimated \$495 million in additional revenue from GST (\$385 million) and duty (\$110 million)
- imply a processing cost to Customs of \$378 million (based on the estimated cost of labour for processing additional international mail parcels)
- impose additional costs on express couriers of \$102 million and Australia Post \$126 million (based on the \$30 per consignment estimated by express couriers and \$10 per consignment for international mail)
- impose additional costs on businesses and consumer of about \$630 million to complete FIDs on international mail parcels (based on \$50 per consignment for 12.6 million parcels).

Effectively, it may cost the community over \$1.2 billion to facilitate the collection of \$496 million in revenue.

The Commission also undertook some illustrative modelling of the impacts of lowering the LVT which (in contrast to the estimates shown in this chapter) allows for a range of consumer responses to increased prices following imposition of the tax and the associated collection costs. As indicated in table 7.6, depending on collection costs these price increases could be substantial. As shown in appendix H, even under assumptions most favourable to reducing the LVT, the model confirms that a \$100 threshold assuming average collection costs of \$50 per parcel would result in sizable welfare losses for the community.

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An alternative approach would be to make only a small movement towards a lower threshold — to \$900 for example. Initially assuming no consumer adjustment to higher prices, at this threshold level, about \$16 million in additional tax revenues would be collected at a cost of around \$9.7 million on an additional 178 000 parcels. On a simple arithmetic analysis, such a threshold appears feasible. But this would leave 99 per cent of parcels with no tax and duty collected, making little improvement to tax neutrality and thus failing to address concerns about ‘level playing field’ competition.

Furthermore, at this threshold level, the number of mail parcels required to be processed would be over three times the current level and, with the current processing system, even this relatively small increase is likely to cause significant delivery delays.

Commission modelling indicates that reducing the LVT to \$500 would similarly result in collection costs significantly exceeding the benefits from removing non-neutral tax treatment.

Thus, even under highly favourable assumptions, with collection costs at \$50 per parcel on average, the additional total collection costs arising from reducing the LVT would outweigh potential gains from removing non-neutral treatment of imported goods. Moreover, at this level of collection costs, the cost of raising the additional revenue would seem high compared with the average cost of collecting GST and other reasonably cost-effective taxes.

Only when collection costs are more than halved (and possibly less than \$12.50) does the cost–benefit trade–off become neutral or positive in some scenarios. While additional revenues are estimated to exceed total additional collection costs at somewhat higher levels of unit collection costs, it is unclear whether this would represent a reasonably cost effective means of revenue raising compared with other taxes. These indicative unit processing costs appear comparable with current charges in the United Kingdom (A\$12) and Canada (A\$8) imposed by their postal administrations.

All the estimates above assume no special or higher threshold for gifts. Although such special exemptions do apply in many other countries they add complexity and are also subject to rorting and abuse. If the objective is to lower collection costs as much as possible then adding a special exemption for gifts is not helpful.

Although it is desirable for all businesses to be treated equally for tax purposes, under the current arrangements the cost to the community of a significantly lower threshold appears to be far too high to make such a change viable. A small lowering of the threshold would not meet the tax neutrality concerns of retailers as the

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majority of parcels would still be entering Australia without duty or GST being paid and, as shown in figure 7.1, it would not raise much revenue either.

The conclusion from this indicative analysis is that any consideration of a significantly reduced threshold would necessitate a radically redesigned and highly efficient revenue collection system. Without a large degree of automation it is hard to see how it would be possible to achieve the sort of figures suggested above. Whether achieving this is possible remains to be seen, but given initiatives abroad in places like Canada and the United Kingdom, it would seem worthwhile to investigate this. Unless it is possible to achieve the desirable improvement in tax neutrality, and at the same time meet a cost efficiency test, then a reduction in the threshold should not occur.

Further, any reduction to the threshold could not be implemented in the short term without very significant cost impacts. The large increase in the volume of parcels being processed for the collection of customs duty and GST would not be possible with the existing facilities and staffing levels. This is particularly the case for international mail parcels where even a small change in the threshold, reducing it to \$800 for example, would have resulted in an increase in the number of parcels to be processed in 2009-10 from 20 000 to about 160 000.

The Post Office Agents Association has raised its concerns about the costs arising from any sudden change in the volume of parcels being processed for revenue, and the ability of the postal system to cope with increased volumes:

If Australia Post is to be used to collect the revenue and processing costs associated with inbound international parcels, then the processes put in place must be efficient and transparent and result in proper cost allocation between the various agencies involved. Australia Post must not be forced to subsidise these operations.

Any taskforce investigating this matter must also take into account the effect that the resultant increase in parcel handline will have on the post office network. If parcels are stored at post offices while awaiting collection and payment, then this will put further pressure on the available storage space at post offices. Many metropolitan licensed post offices are already experiencing parcel storage capacity issues, a problem especially in areas with high retail rents. (trans., p. 121)

Before the threshold is changed a new approach for processing parcels, particularly those in the international mail stream, is required. Any new approach to processing parcels should meet a number of criteria:

- imposing minimum delays in the delivery of parcels to businesses and consumers
- allowing for the large expected increase in parcel volumes associated with the growth of online retailing

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- passing on collection costs to the end consumer
  - minimising manual processes to the greatest extent possible
  - imposing no added barrier to trade, or protection of domestic industry from import competition
  - not having a higher threshold for gifts, if this would add to complexity and to incentives to inappropriately use this special exemption.

## 7.9 Options for reforming processes

### Customs duty

#### *Set separate thresholds for collecting customs duty and GST*

The collection of customs duty is more burdensome than the collection of GST and yields less revenue. In order to assess the amount of GST on a parcel, Customs only has to establish the value of the parcel and any other costs, such as freight, included in the Value of Taxable Importation. Assessing the applicable level of customs duty requires establishing not only the customs value of the goods, but also the place of origin and the correct tariff classification.

While it is more difficult to correctly assess the amount of duty than the amount of GST, the revenue produced is approximately a quarter of the amount. Moreover, the revenue generated by customs duty is expected to continue to decline in the future as rates of duty fall and more preferential trade agreements are negotiated.

These factors suggest that consideration should be given to setting a separate, higher, threshold for duty than for GST. Having a lower threshold for GST than for duty would simplify the collection of GST, as the amount of tax can be assessed from the declared value of the parcel without having to obtain the more detailed information required to assess the amount of duty due. This would also minimise any additional delays.

#### *Rationalisation of customs duties*

The processing of parcels might also be made more efficient by rationalising the schedule of customs duties. Currently there is a multiplicity of customs classifications which sometimes apply different rates of duties to very similar

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goods. The current tariff classification arrangements may be adding an unjustified level of complexity to the collection of duty.

Revising and simplifying the tariff schedule may both reduce the administrative burden of assessing tariff duties and produce economic gains for Australia. This could be done either by reducing tariffs on some goods to the same level as the tariffs on similar goods, or by introducing a simplified tariff schedule for lower value goods. In its recent study of trade agreements the Commission found that:

While Australia's previous unilateral reform efforts have reduced tariffs substantially, even at current (low) tariff levels the modelling conducted as part of this study suggests that much of the future economic gains available to Australia from tariff reductions could be achieved through unilateral reform. (PC 2010b, p. XXVI)

Japan already has a simplified tariff applicable to goods valued at ¥100 000 or less (A\$1147.45). The simplified tariff schedule reduces thousands of categorised items to six categories, and alcoholic beverages (Japan Customs 2011).

In its 2011 Budget, the Canadian Government announced that it is initiating a process to simplify the Customs Tariff in order to facilitate trade and lower the administrative burden for businesses. It proposes to introduce new tariff items to the Customs tariff to facilitate the processing of low value non-commercial imports arriving by post or courier. These will simplify the Canada Border Services Agency's tariff classification process of postal and courier imports with values less than Can\$500 (A\$480) (Canada 2011).

In the longer term, Canada intends to replace its current process for rating goods individually with a simplified tariff rate under its strategic review initiative. The Generic Harmonized System code will apply to low risk, low value, goods. Under the existing postal program, 50 per cent of the CBSA's costs are dedicated to rating the duties and taxes on parcels that fall into the low value shipment category. The CBSA anticipates significant savings from the proposal (CBSA 2010).

In the United Kingdom, goods brought in by travellers from outside the EU which are valued at above the duty free allowance of £270 (\$A417), but at less than £630 (A\$972), have duty applied at a flat rate of 2.5 per cent (HMRC 2011).

The Commission understands that in the United Kingdom the process of assessing duty is simplified by using software which identifies the most appropriate customs tariff based on the limited information carried on the CN 22 or CN 23 label.

Developing a simplified tariff for goods entering Australia with a value below \$5000 may significantly reduce the cost of processing low value imports, and avoid the need to employ customs brokers for such imports. This approach appears to

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work well in other jurisdictions. It is understood that Australian Customs already use some form of simplified tool for assessing duty on personal goods carried by incoming air passengers which exceed the duty free concession.

In response to the draft report the Fair Imports Alliance (FIA) urged the Commission to give greater consideration to tariff reform:

The FIA believe that reducing taxes, duties and tariffs imposed on imports [by] Australian wholesale distributors, suppliers and retailers would reduce the costs of imports from their place of manufacturer and allow sales to Australian consumers at a cheaper price. The imposition of unnecessary duties and outdated tariffs should be removed and proposed reductions in tariffs should be brought forward. (sub. DR171, p. 6)

Similarly, the Australian National Retailers Association (sub. DR190) recommended immediately removing customs duty from all consumer goods except clothing, textile and passenger vehicles. It suggested that planned reductions of duty on clothing and textiles in January 2015 should be brought forward to January 2012, and that the duty on clothing and textiles be eliminated by 2015.

The Commission has previously considered both general tariff arrangements and the assistance provided to the textile, clothing and footwear industries (TCF). In 2000 the Commission found that even the 5 per cent general tariff continued to distort producer and consumer choice and reduce the international competitiveness of a range of Australian producers. The Commission also noted that the interaction of tariffs and a complex set of concessional duty arrangements causes significant monitoring and compliance costs for business. The Commission recommended that general tariff rates be reduced to free no later than 2003 (PC 2000).

In 2003, the Commission conducted an extensive review of TCF assistance. It found that there would be advantage in continuing the step down approach employed in the then current assistance package and said that its preferred option was to maintain tariffs on apparel and certain finished textiles at 10 per cent until 1 January 2015, and then reduce them to 5 per cent (PC 2003). There does not appear to be a strong case for altering the current timetable for reducing TCF tariffs, bearing in mind the potential impact on all of the affected parties.

## **Full Import Declarations**

The main difference between the information required for a customs declaration on an international mail parcel, or through a SAC, and that required for a FID relates to identifying the tariff classification and statistical code for the goods. This information is set out in the *Customs Tariff Act 1995* which is over 1500 pages long.

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It is unrealistic to expect small businesses or consumers to be able to accurately identify this information without assistance.

The paper based process for FIDs of international mail parcels appears to be unnecessarily burdensome on Australia Post, Customs and addressees. It should be possible to develop an online system which would allow an addressee to enter the information required by customs.

Maintaining or increasing the current threshold for a FID and streamlining the procedures, would minimise the costs to all stakeholders. Alternatively, the need for some of the additional information required for a FID might be avoided by changing the way customs duties are applied to low value consignments and reviewing the need to gather statistical data on lower value consignments.

Customs has acknowledged the drawbacks of the current system for processing parcels which are above the threshold. In response to requests for information by the Commission it said that:

The development of a simplified electronic solution would have particular benefits for private importers, as an alternative to extending current arrangements to require formal manual declarations for low value goods. This would require additional funding to develop systems and provide resources for the collection of the additional GST (and, potentially, duty), and the implementation of a cargo intervention and compliance strategy for revenue collection for low value goods. (Customs 2011c, p. 1)

### **Information on international mail parcels**

At Australia Post's international gateways, parcels are manually sorted to identify parcels with a value above the threshold. Information on those parcels is then manually entered into Australia Post's and Custom's systems. Streamlining this process would bring gains in efficiency to the Australian economy and would facilitate the collection of taxes on lower value parcels. This could be achieved by having electronic information linked to each parcel. Customs and AQIS would also be better able to risk assesses parcels for border protection purposes if more information were readily available. However, it may be difficult to introduce any change along these lines unilaterally as Australia Post does not control the receipt of parcels by overseas postal agencies.

Little progress appears to have been made in Australia on moving away from manual processing. In 1998, the Joint Committee on Public Accounts and Audit recommended that Australian Customs and Australia Post should examine improvements that can be made to, and international progress with, bar coding and related item identification systems for imported goods (JCPAA 1998). In response

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to that report the (then) Parliamentary Secretary to the Minister for Finance and Administration said that:

Customs and Australia Post are agreed that priority should be given to the introduction of streamlined postal clearance procedures, particularly through the electronic reporting of postal consignments at item level. Customs coordinated the preparation of a paper, arguing options along these lines with Australia Post. This paper was presented in September 1998 to the World Customs Organisation (WCO), the Universal Postal Union (UPU), national postal authorities and the International Express Carriers Council.

The paper envisages a staged approach, initially focussing on business mail and commercial parcels, with postal authorities to report electronically to Customs. Bar coding of individual items and use of the World Wide Web will be evaluated and a pilot project is planned for early 1999 between US/UK/Australia. (Slipper 1999, p. 4)

Customs has advised the Commission that the UPU is currently in the process of developing and trialling a pilot Customs Declaration System which is intended as an electronic reporting tool between postal agencies and customs administrations. The system being trialled would be reliant on data capture arrangements being agreed and implemented across the UPU membership (Customs 2011c).

## **Fees and charges**

At present the threshold for exemption from duty and GST also applies to fees and charges. Only imports which are entering through a FID are required to meet the costs of processing imports by paying Customs Import Processing Charges and AQIS Import Declaration Fees. Importers of low value goods benefit from not having to pay charges that are imposed on importers of higher value consignments. It could be argued that this creates a distortion of the market which favours importers of low value parcels over the importers of higher value consignments.

Even though items valued at below the threshold are not subject to the collection of taxes, Customs has to assess whether any taxes are due, and Customs and AQIS have to screen these items for dangerous or prohibited goods. At present the costs of processing are recovered with respect to consignments above the threshold and bulk imports, but not for items below the threshold. A charge which reflected the costs of processing would remove a possible distortion in favour of small consignments, and any consequent inefficiency.

Having said that, the collection of charges on millions of parcels on which no taxes were being collected would be problematic. The most efficient way of doing so would be to collect the charge in bulk through Australia Post (for postal items) and through the express courier businesses for the consignments they are carrying. The

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charge might be recovered by the carriers from the persons sending the parcels. However, the Commission understands that Australia Post may be unable to recover charges of this nature from foreign postal services. It would therefore be forced to absorb the cost, or attempt to collect the charge from the individual recipients of the parcels.

### **Responsibility for collecting revenue**

Currently in Australia revenue on air cargo parcels is collected from the addressee by the carrier, while revenue on international mail parcels is collected from the addressee by Customs through its ICS. However, as noted above, in the United Kingdom and Canada the postal authority is responsible for collecting the revenue from the addressee, and it is allowed to collect a fee to recover its costs in doing so.

This would appear to be a more efficient way of collecting revenue on international mail parcels than the current multi-step Australian system which involves both Customs and Australia Post. However, it may be necessary to introduce legislation to allow Australia Post to carry out this role. Any revised arrangements would also have to ensure that Australia Post and express carriers did not have to bear the cost of taxes and charges if an addressee refused to accept delivery of a parcel.

### **Changing the point at which GST and duty is collected**

Changing the point at which GST is collected from the border barrier could improve the efficiency of the process.

There are already some arrangements in place which allow international online retailers to collect taxes at the time of sale and pass them on to the government of the country where the buyer is located (appendix F). An arrangement of this nature would be an efficient way to collect GST. But adopting this approach would require other changes to processes.

Arrangements would have to be put into place to ensure that when the parcel arrived at the border it could be identified as having already had tax paid on it, and the tax due reconciled with the tax forwarded by the retailer. The success of this approach would probably depend on there being incentives for overseas online retailers and their customers in Australia to participate in these arrangements. It may also be difficult to extend this approach to smaller online retailers who only make occasional sales to customers in Australia.

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There are already arrangements within the EU under which online retailers in and outside the EU who exceed a certain level of sales to consumers in another country can be required to register for VAT in that country. An arrangement along these lines would be dependent on international co-operation.

Another alternative may be to collect GST on overseas purchases made using credit or debit cards by requiring card issuers to collect the GST as part of the transaction. The Commission sought information from financial intermediaries on the feasibility of this option. In response Visa advised that:

Visa is of the view that we could not perform this function. It is noteworthy that Visa does not perform this role for any other jurisdiction globally.

The core reason for our inability to perform such a function is that no technical data solution exists to deliver the suggested collection outcome. It is important to also note that no Visa-controlled steps exist that would change this situation. (sub. DR123, pp. 1-2)

The Commission understands that the current system for processing payments does not allow the identification of the individual components of a transaction which would be needed to identify what taxes were applicable. The Commission is not aware of any government which is currently using this approach.

## **7.10 Overseas online purchases of intangibles**

At present, GST is not being collected in Australia on services and intangible goods (such as computer software, games, music, videos and electronic books) purchased by consumer from overseas (Board of Taxation 2010). The revenue likely to be lost from this source in 2010-11 was \$1 billion (Treasury 2011). This is approximately twice the amount of revenue which is being forgone as a result of the low value threshold on goods.

Within the European Union this issue has been addressed by taxing the supplier of services to consumers in the country where the supplier is located. The general rule within the EU is that the supply of services to a taxable person are taxed at the place where the recipient is established. But the supply of services to non-taxable persons is taxed in the place where the supplier has established their business. This approach avoids the difficulty of identifying and taxing consumers as the supply of services to consumers is brought within the tax net by taxing the business which is supplying the service (EU 2008). Where the supplier is established outside the EU the place of taxation is the country where the consumer is located.

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The Commission's investigations of this issue have not identified other jurisdictions which are able to effectively bring these purchases within the tax system. While some countries, such as Switzerland, have regulations making foreign suppliers liable for VAT enforcing those regulations is difficult. Failing the cooperation of major suppliers of such intangibles, these transactions might be brought into the tax system if a workable means was found to collect the GST at the time of the transaction through the credit or debit card issuer, but for the time being this seems problematic.

Any effective approach to this issue would appear to require international cooperation, and might best be explored by an international body such as the OECD.

## **7.11 The way forward**

The Commission is of the view that the exemption from payment of GST and customs duty on goods valued at less than \$1000 is not the main factor affecting the international competitiveness of Australian retailers. This is particularly so due to the current large difference (in excess of the 10-20 per cent accounted for by the GST and duty) between domestic and overseas retail prices for many goods purchased online. Other factors influencing this judgement include: some consumers shop online overseas because they can not obtain the goods they require locally; the cost of freight on individual items is comparatively high and provides some natural protection; and the willingness of Australian consumers to pay a small premium (some have suggested 20 per cent) for the security of purchasing from an Australian supplier. Indeed the issue of the level of the LVT may be distracting attention from more fundamental issues facing the retail industry arising from their increasing exposure to international competition.

Nonetheless, in principle, the GST, as a broad based consumption tax, should apply equally to all transactions. Having no low value threshold and subjecting all imported goods to the payment of GST would minimise distortions in resource allocations, losses in efficiency, and consequent reductions in community welfare. But there are circumstances under which it is inefficient to impose compliance costs on the government and the community in an attempt to collect small amounts of revenue.

The LVT with respect to customs duty undermines the protective effect of the tariff assistance provided to industries where duty is applicable. Again, however, the negative effect of the threshold on industry needs to be weighed against the benefits consumers receive from lower costs of goods and the impact of administrative and

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compliance costs. The collection costs for duty are far more substantial than the collection of GST because of the varying rates of customs duty depending upon the product category and source country. Ascertaining the correct rate of customs duty on small consignment is burdensome and usually beyond the expertise of most consumers.

While mindful of the views of several retailers (box 7.5), the evidence strongly suggests that precipitate action to lower the threshold would bring with it net costs to the community. The current costs of collection would need to be significantly reduced to support such a decision. In the Commission's assessment, resources should be devoted to exploring the most cost-effective and expeditious manner of reducing collection costs to facilitate a cost-effective approach to greater tax neutrality.

The current parcel handling logistics processes used in Australia by Customs and Australia Post need to be significantly improved. In fact, it has become clear during the course of this inquiry that such processes need to be examined irrespective of changes to the LVT. Current processes appear not to be up to the task of accommodating the future demands of expected growth in online retailing. An overall examination of the processing system should seek to lower costs of processing international mail. The challenges in the express courier system are less than with the mail system, but costs are still far too high to be appropriate with a much lower LVT.

Processes associated with the operation of the Custom's barrier, and in particular unnecessarily high costs or long delays in processing and delivering parcels, should not be accepted simply in order to shelter retailers from international competition. It should be noted that not only consumers, but many smaller retailers and other businesses would be adversely impacted by any system which imposed large delays or added unreasonable costs over and above the relevant GST and duty payable. This is particularly the case for any registered business importing low value items, as in that case it is unlikely that there would be any ultimate loss of GST revenue anyway.

Accordingly, the Government should investigate a new approach to processing incoming parcels, particularly those in the international mail stream, although costs also need to be examined in the express carrier stream. The Government should establish a taskforce of independent experts to design a new system for processing lower value parcels. The terms of reference should outline the criteria, set out earlier in this chapter (section 7.8), which any new system must satisfy. The members of the taskforce should be experienced in the design and implementation of systems capable of sorting and processing larger volumes of consignments. Although not

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members of the taskforce, it should be advised by Customs, AQIS, Australia Post and CAPEC.

### **Box 7.5 Responses to the draft recommendations**

We maintain the Productivity Commission should recommend the LVT is lowered to \$100, until there is international agreement to standardise *de minimis* thresholds. (Shopping Centre Council of Australia, sub. DR186, p. 5)

We would further like to see the time process for the reduction of the \$1000 threshold to be tightened up. We feel that there is a long lag and that there is an opportunity for that to be sped up and to be tightened up. (ARA, trans., p. 4)

The pessimistic view would be that if the report isn't altered insofar as it's focussed on the implementation of actions of recommendation, there will be no relief for the Australian retail sector until perhaps 2014. (NRA, trans., p. 58)

I think that the Commission has recommended that the government report in 2012. The Assistant Treasurer has made it clear in public comments that it would be at least two years after that report which to me, in government terms, sounds like 2014, possibly 2015. In terms of the pace of change of the retail sector, we believe the marketplace is changing such that some of those changes probably need to occur sooner. (ASGA, trans., p. 84)

We again support the formation of this but we are concerned about the time it would take. ... If we wait another three years, five years, we're talking 30 per cent in five years. The Australian bike industry can't sustain that. So those time frames for us are very critical. (Bicycle Industries Australia, trans., p. 137)

CAPEC also welcomes the establishment of a taskforce charged with investigating new approaches to the processing of low value imported parcels, and greatly appreciates the endorsement of having CAPEC involved in this process. A more efficient border clearance and revenue collection system would benefit all key stakeholders. (CAPEC, sub. DR156, p. 1)

We affirm the Commission's conclusion that, in principle, the LVT should be reduced to ensure tax neutrality. However we are concerned that the creation of a taskforce to investigate the system of processing parcels will result in a significant delay before the achievement of such tax neutrality on imports, if at all. (ForTheRiders Bike Shop, sub. DR158, p. 1)

We are concerned about the timeframes associated with any change stemming from this taskforce, with the retail sector, especially the bicycle sector suffering considerably from the massive growth in offshore online purchasing. ... A speedy response is required to prevent the bicycle sector, which employs over 10,000, being forced to reduced both staffing levels and services to the community. (Colony BMX, sub. DR 169, p. 2)

The Fair Imports Alliance supports changing the parcel handling processes of both air and sea cargo and international mail, thus reducing the administrative compliance and enforcement costs of administering the LVIT, and allowing it to be reduced. ... The FIA strongly urges the Productivity Commission to convey to the Government the sense of urgency in creating greater efficiencies in the handling of inbound packages by air and sea cargo or international mail. The FIA believes that the removal of the competitive disadvantage imposed by the current LVIT should be a priority for the Government and does not believe that the retail sector should have to wait three years before it sees any change. (Fair Imports Alliance, sub. DR171, pp. 5-6)

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The proposal to establish a taskforce was canvassed in the Commission's draft report. Most responses to the draft report supported this general approach while suggesting some refinements. Australia Post (sub. DR192), for example, suggested that a representative of AQIS should also be invited to act in an advisory role to the taskforce. The Commission agrees and has amended its recommendation accordingly. The Australian Retailers Association (trans., pp. 4-7) suggested that industry bodies representing retailers affected by the LVT should also be involved in the taskforce as some of their members have experienced difficulties under the current system and would be able to contribute to improvements. While the taskforce should consult widely with regular importers and other stakeholders, they are not as central to the implementation of any changes as the businesses and agencies which will have to implement those changes in their own facilities.

A number of responses to the draft report raised concern about the time frame for the taskforce's report and the implementation of changes (box 7.5). Their concerns are understandable. Nevertheless, until a revised process is designed it is not reasonable to nominate a fixed timeframe for its implementation. It is important, therefore, that the taskforce recommended by the Commission report back in 2012 with a tight, but achievable, proposed timetable for improving the processing system.

From preliminary investigations, the Commission is aware of some international initiatives and processes already in place which have the potential to lower the costs of collecting taxes and duty on incoming low value parcels. It should be noted that this is a rapidly changing scene. Other countries have also been grappling with these sorts of challenges and several of them have already developed promising improvements which might be employed here. These include:

- encouraging larger online retailers to collect applicable taxes at point of sale
- the collection of electronic data on international mail parcels
- for mail parcels, using Australia Post to collect the revenue and processing costs, rather than the current multistep clunky process between Australia Post and Customs
- greatly simplifying duty assessment by having a limited number of rates and classifications (e.g. ten or less) for low value items, rather than the current system of entering items by individual tariff code which often requires using a customs broker.

Once a more efficient system has been fully investigated, utilising international best practice, the costs and benefits of implementing any new process should be assessed. If a new process can satisfy the criteria noted above (section 7.8) and meet the needs of Customs and AQIS for their other border protection responsibilities,

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the LVT arrangements should then be reassessed and the most appropriate threshold for Australia determined. In determining the most appropriate level to which the LVT should be lowered the additional tax revenue from all sources should be compared to the costs of collection and any other costs to consumers and businesses, such as the loss of consumer surplus.

The Commission understands that the investment required in the mail system is likely to be significant, and a new process may take some time to fully implement.

RECOMMENDATION 7.1

*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 7.2

*The Government should establish a taskforce charged with investigating new approaches to the processing of low value imported parcels, particularly those in the international mail stream, and recommending a new process which would deliver significant improvements and efficiencies in handling. The taskforce should comprise independent members, with the Australian Customs and Border Protection Service (Customs), the Australian Quarantine and Inspection Service (AQIS), Australia Post and the Conference of Asia Pacific Express Carriers providing advice. The terms of reference should outline the criteria that any new system must satisfy including: minimising the costs of processing and delivery delays, streamlining the assessment of Customs Duty, user pays, and without compromise to the border protection functions of Customs and AQIS. This review should report to Government in 2012 and propose an expeditious timeframe for its proposed changes.*

*Once an improved international parcels process has been designed, the Australian Government should reassess the extent to which the LVT could be lowered while still remaining cost-effective.*

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## 8 Planning and zoning regulation

### Key points

- 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 anti-competitive 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 definitions and/or processes) to allow new and innovative firms to enter local markets and existing firms to expand.
- A number of overseas studies have examined the impact on the retail industry of some land use regulations that restrict the establishment of new large format stores. These studies suggest that restricting the development of larger stores lowers retail productivity, reduces retail employment and raises consumer prices.
- Overseas evidence also suggests that some land use restrictions raise property prices in residential and commercial markets by constraining the quantity (and location) of available space. These empirical results are useful directional proxies for the impact of planning and zoning controls on domestic retail property values.
- In its recent benchmarking study on planning, zoning and development assessment, the Commission identified a number of leading practices to support competition. While all these leading practices should be implemented to improve the competitiveness of the retail market, two are of particular importance:
  - 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.

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## 8.1 How planning and zoning affects retail in Australia

Planning and zoning regulation establishes how land can be used and how such uses can be changed. Land use planning is the process of making decisions to guide future allocation and development of land.

State and territory governments identify long-term goals and objectives such as:

- promoting the orderly and economic use and development of land
- preserving the environment
- providing and coordinating community services and facilities.

They then determine the best approach for achieving these objectives in their state and territory plans. Local council and regional plans are intended to be consistent with the higher level goals and objectives of the state and territory plans.

Generally, within a local development plan, each council area is divided into ‘zones’. Zones group together areas with similar characteristics by integrating mutually beneficial uses and separating incompatible uses so that the wider community does not have to bear the cost of ‘externalities’<sup>1</sup> that could otherwise be generated. Zones are typically based on land uses such as residential, commercial or industrial. Each zone is defined by criteria that set out the detail of the acceptable and unacceptable uses for the zone. In practice, zones are used to prevent new developments from interfering with existing residents or businesses or to preserve the character of a community.

To ensure that a proposed development to use the land is consistent with the local policy for the area, as stipulated in the relevant planning and zoning ordinances, most developments undergo assessment. The assessment process ensures that the development complies with the plan for the council area, region or city (PC 2011b).

### Activity centres policies

In terms of retail activities, state and territory governments’ planning policies are formulated around the ‘activity centres policy’. Activity centres policies seek to

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<sup>1</sup> Externalities are impacts on others that are not taken into account by a private economic agent. Negative externalities can arise from pollution, noise or other environmental factors and, in the case of property, can have an impact on both quality of life and property values. Negative externalities provide a rationale for government intervention when the private benefits to a given land use are outweighed by the costs to others and compensation is not automatic.

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deliver benefits to the community by concentrating retail and other employment activities into specified locations (box. 8.1).

**Box 8.1 Commonly cited benefits of ‘activity centres policies’**

1. More sustainable travel including:
  - reduced passenger Vehicle Kilometres Travelled (VKT) per year per capita
  - greater physical activity.
2. Enhanced agglomeration economies including:
  - labour productivity enhancement
  - increased human capital.
3. Concentrations of development density leading to:
  - greater housing density
  - efficient utilisation of infrastructure and resources
  - avoided consumption of rural and agricultural land.

*Source:* SGS Economics & Planning (2011).

According to the NSW Department of Planning and Infrastructure (sub. 114), enabling people and businesses to spend less time travelling to work, shops and services, is intended to:

- promote productivity and better infrastructure utilisation
- reduce car use, energy use and emissions
- support a more active and healthy lifestyle (by walking more).

As a consequence, out-of-centre developments are generally discouraged by state and territory planning policies.

All jurisdictions have activity centres policy provisions of some kind, either as a stand-alone policy document or as part of their strategic plan. Activity centres are designed to create areas that attract and support large numbers of people for a variety of purposes including employment, retail/shopping, community services, social activities and, more recently, high-density housing.

The Retail Traders’ Association of Western Australia (RTAWA) highlights the downside risks of activity centres policies for consumers and retailers if they fail to deliver a shopping location consistent with their preferences:

The challenge with all such planning implementation is that market forces are being totally ignored, what is considered by government bureaucrats as a great location for an activity centre is not necessarily where market forces would place the centre. This is

especially of note as retail is always the first industry to be present at such centres. A further implication here is that all activity centres need to cater for all retail tenancy formats — high street, shopping mall, big box, as well as growth of those formats overtime, but also understand that each such format must present a feasible cost alternative so as to allow retail businesses to expand from or shrink down to a suitable cost basis to sustain their business format — the alternative is the loss of the business because the format is outgrown or now too expensive. (sub. 80, pp. 12-13)

Activity centres are important for competition because they control where most businesses locate within an urban area. Activity centres, by their nature, can directly influence the competitiveness of businesses by controlling the number, type and location of allowable activities.

Activity centres policies prescribe which broad activities — residential, retail, commercial — are permitted within centres as compared to the edge of centres or outside of centres. The hierarchy of activity centres generally establishes the type and size of activities which are permitted to locate in each level of centre. Table 8.1 outlines the five broad activity centre types that occur in most Australian jurisdictions.

**Table 8.1 Activity centres hierarchy**

<i>Category of centre</i>	<i>Description</i>
City centres	Primary centre for finance, law, education, health, arts, tourism, specialised and high end retail. Preferred location of land uses of state, national and international significance. Major employment area and transport hub. City and even state-wide catchment.
Major regional centres	A 'strategic centre' providing a wide range of retail, commercial, administrative, entertainment, recreation and regional community facilities. Key employment area and transport hub. Catchment drawn from a significant part of the city.
District centres	Centre for a range of retail, commercial services, office and community facilities.
Suburban centres	Centre for sourcing weekly needs and certain personal services. Catchment of local and nearby suburbs.
Local centres	Centre for meeting the day-to-day needs of those in the suburb.

Source: PC (2011b).

While locating commercial activities outside of these centres is discouraged to varying degrees, retail 'out-of-centre' developments have been more prevalent since the 1990s, as numerous bulky goods retailers received planning permission to locate in out-of-centre locations (such as industrial areas and airport land).

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Prescriptive requirements for activity centres can limit the availability of sites in those centres for different business types — that is, they can be exclusionary in character. (In the same way, prescriptive requirements for bulky goods retailers located outside activity centres — such as restrictions on business type or minimum retail area — are also exclusionary). These exclusionary effects tend to be more prevalent at the lower end of the activity centre hierarchy. For example, local centres (such as a neighbourhood or village centre) may exclude the operation of a slightly larger grocery retailer if its products are deemed to provide for the weekly rather than day-to-day needs of local residents. In addition, given local centres are typically promoted as destinations for small scale commercial or retail activities, there are sometimes maximum floor space restrictions to prevent the establishment of larger businesses.

While prescriptive requirements provide some clarity for developers, they can also make it difficult for retailers (especially those with new business models) to find suitable sites and thus enter the retail market. At the same time, they also prevent or delay existing retailers from modifying or expanding their businesses — foregoing potentially higher returns and/or incurring higher costs by having to conform with regulatory requirements.

In the current retail environment, where there is increasing competition from online retailers, and changing consumer preferences more generally regarding their shopping experience, the extent to which planning regulations should be used to restrict new businesses entering markets, or even to preserve existing activity centres, is increasingly problematic. To prevent developments that are perhaps more closely matched to evolving market requirements may undermine the ability of retailers to respond to consumer preferences and thus accelerate the decline of existing centres. These issues are discussed in section 8.4.

### **Retail floor space in Australia**

Current planning arrangements have produced 45 million square metres of retail space in Australia which over time is increasingly distributed towards shopping centres. While most retailing still occurs outside of shopping centres, centres represent a growing share of the total market. The contribution of shopping centres to total retail space increased from 28 per cent in the early 1990s to 38 per cent in 2005-06 (PC 2008c).

As a result, non-centre retail space fell from 72 per cent to 62 per cent of total retail space over the same period. Within the non-centre retail market, stand-alone bulky

goods sites and direct factory outlets are increasing in importance relative to retail shopping strips (PC 2008c).

According to the Commission's 2011 report *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments*:

In the 14 years to 2005-06, the supply of shopping centre floor space increased by almost 90 per cent to 17.3 million square metres. Over the same period, non-shopping centre retail floor space increased by 16 per cent to 27.3 million square metres, due mainly to the growth in stand-alone premises such as bulky good precincts. (PC 2011b, p. 679)

The growth in Australian retail floor space has outpaced the growth in population, with retail floor space per capita increasing from around 2.4m<sup>2</sup> per person in the early 1990s to nearly 3.0m<sup>2</sup> in 2005-06 (SCCA 2010). Commission estimates of retail floor space per capita are reported for most Australian capital cities in table 8.2.

**Table 8.2 Retail floor space per head of population<sup>a</sup>**  
Capital city planning areas, m<sup>2</sup> per person

	<i>Sydney</i>	<i>Melbourne</i>	<i>Perth</i>	<i>Adelaide</i>	<i>Hobart</i>	<i>Canberra</i>
Year determined	2010	2007	2008	2010	2010	2009
Total area per head of population (m <sup>2</sup> /person)	3.00	2.16	2.74	2.34	1.03 <sup>b</sup>	2.70

<sup>a</sup> Some estimates may not be strictly comparable due to differences in jurisdiction definitions of 'retail' and the completeness of the data collection in the respective studies. The Commission was unable to obtain city-wide data for Brisbane or Darwin.

<sup>b</sup> The Hobart measure is an under-estimate as it is based on retail space in shopping centres only.

Source: PC (2011b).

While there is some variability across the selected cities, most cities have ratios of between 2m<sup>2</sup> and 3m<sup>2</sup> per person. Hobart is not directly comparable because its estimate is based on retail space in shopping centres only.

The growth in floor space for bulky goods retailing is outlined in table 8.3. In the ten years to 2007, bulky goods floor space accounted for nearly 40 per cent of the total supply of new retail floor space in major Australian markets. Floor space per person for bulky goods is now roughly similar in the major mainland state capitals. In 2009-10, there were at least 27 new bulky goods centres opened, under construction or in the planning stage — adding a total of over 600 000m<sup>2</sup> of retail space.

**Table 8.3 Bulky goods retail floor space per head of population**

Capital city planning areas, m<sup>2</sup> per person

	<i>Sydney</i>	<i>Melbourne</i>	<i>SE Qld</i>	<i>Perth</i>	<i>Adelaide</i>
1997	0.32	0.37	0.34	0.34	0.34
2002	0.37	0.42	0.46	0.42	0.36
2007	0.46	0.48	0.55	0.45	0.42

Source: PC (2011b).

Some inquiry participants, such as Mr Alex Hrelja, suggest there is an over-supply of retail floor space in some specific retail locations in Australia:

There appears to be simply too much floor space and too many shops to meet the market demand in some key retail locations at the current time.

... As an example in inner Melbourne, a prime retail market, the following developments have opened in recent years in a context where the City of Melbourne already had about 600 000 square metres of retail space: South Wharf DFO, Harbour Town Docklands, Costco Docklands, Spencer Street Retail, QV City, Victoria Gardens Richmond, various big box stores and on it goes. (sub. DR132, p. 1)

While the amount of retail space per capita has grown in recent years, it is not clear what the optimum level may be from a community-wide perspective taking into account all costs and benefits. This inquiry has not attempted to assess whether there is an under or over-supply of retail floor space in specific locations. Rather, it considers how to ensure that planning and zoning regulations do not impede the flexibility of the retail industry to respond in a timely manner to changing consumer preferences and developments in retail formats. Both of these factors are important in enabling the industry to continue to contribute to community welfare in the future.

## **8.2 The impact of planning and zoning regulations on retail competition — overseas evidence**

Competition creates incentives for businesses to produce the goods and services customers want. For consumers, competition can deliver more convenient access to a wider range of better quality and lower priced goods and services. For retailers, competition can spur innovation — such as new retail formats — leading to higher retail productivity and profits. To enable competition to deliver these benefits it is essential that businesses have the flexibility to respond to market demands. However, at times, business flexibility can be restricted by excessive regulation and unduly restrictive policies.

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Overseas evidence suggests that unduly stringent planning and zoning arrangements can have detrimental effects on competition in the retail industry. According to Pellegrini (2000), the rationale for planning and zoning regulation is based on two considerations:

- the control of ‘externalities’ on neighbouring land uses
- the optimisation of the planning of public facilities, such as roads and other network infrastructure, which are normally provided by state and/or local authorities.

These objectives are conceptually straightforward and generally accepted, but it is not always clear whether the benefits of particular land use restrictions outweigh the costs to the community since benefits and costs do not appear to be explicitly measured and compared. In some ways this is understandable because many of the benefits and costs of land use restrictions are likely to be difficult to measure in a robust manner.

Giertz (1977) argues that zoning may promote local monopolies:

Although there is a strong economic argument for zoning in certain situations, there is little evidence to suggest that zoning is always justified in real world circumstances. While the proponents of zoning almost always base their case upon the externality argument ... there may be many situations where the real motivating factors are quite different. Zoning, justified as a means of internalising externalities, may, in fact, be a powerful tool for promoting monopoly. (p. 50)

Suzuki (2010) argues that stringent land use regulations generate a distortion in local business markets by discouraging entry (by increasing costs) and as a result, lessening competition.

According to the OECD (2008), planning and zoning regulation creates the most severe competition problems when:

- the regulations prevent new firms from entering in markets where there is market power
- the regulations prevent low-cost firms from entering in markets where existing firms are high-cost
- the regulations reduce the total supply of a good or service
- the regulations unduly delay the arrival of a good or service that consumers would value (such as one resulting from innovation or differentiation). (p. 23)

Location of retail competitors is important because travel distances matter for consumers. Competition between retailers depends on both product price and individual retailer location. Retailers who are far away from their competitors may

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find it possible to charge higher prices than if they are located close to each other. When assessing a potential location for a new store, retailers factor in access costs for consumers. And when assessing a new place to live, consumers factor in the location of shops amongst other factors like workplace, schools and environmental amenity (OECD 2008).

Competition among retailers on product prices is generally most intense when they are geographically close to each other. By being in the same location, no individual retailer is at a competitive advantage or disadvantage in relation to access — since individual consumers face the same travel cost to visit each retailer. While this type of localised competition is becoming less prevalent for those goods that are most easily purchased on the internet, to the extent that restrictive zoning and activity centres policies locate retailers closer than they would otherwise choose, these policies may improve competition and lower prices. For example, where the retail zoned area is sufficiently large, the effect may be to concentrate stores without excluding any stores. According to the OECD (2008):

This could actually increase the vigour of rivalry between stores, by reducing search costs for customers who might otherwise have to visit highly dispersed locations in order to compare offerings. (p. 29)

But if there is a scarcity of appropriately zoned retail space (that is, some retail stores are excluded from the area because of insufficient space), or there are large numbers of prescriptive requirements which unjustifiably restrict competition, planning and zoning can have a harmful effect by creating local retail monopolies. 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.

Ridley et al. (2011) show that with respect to five different product markets, restricting their areas of operation leads to increased densities of stores in appropriately zoned areas, reducing consumer search costs, resulting in increased competition and lower prices. The United Kingdom Competition Commission's report *The supply of groceries in the UK market investigation* (UK Competition Commission 2008) found that competitive pressure on existing retailers increased after a new store entry nearby (box 8.2).

The UK results did not specify whether the sales revenue impact on incumbent stores was driven by price changes (or volume changes). Recent Australian evidence provided by the Australian Competition and Consumer Commission (ACCC) is more precise. When the ACCC investigated the pricing behaviour of the two major supermarket chains (Woolworths and Coles), it reported that prices at these supermarkets were lower when a competitor is located nearby (ACCC 2008d).

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Such evidence suggests that a planning system that brings about intense retail competition can deliver benefits to consumers.

**Box 8.2 Effect of new store entry on revenue of incumbent stores**

The UK Competition Commission's report *The supply of groceries in the UK market investigation* analysed the impact of new store entry on the sales revenue of existing grocery stores in the same local area. Using data for 2001 to 2006, it assessed how revenues of mid-sized stores and larger stores were affected by entry into the same local area of other mid-sized and larger stores. The impacts vary depending on the distance of the entrant from the existing stores and on the relative size of the stores.

For example, the Competition Commission's analysis shows that for incumbent larger stores, entry by a new larger store within a five minute drive reduced revenues of the incumbent store by around 7 per cent. Entry within a five to ten minute drive time reduced revenues of the incumbent store by around 5 per cent and entry within ten to fifteen minutes by around 2 per cent. Where the new entrant is a mid-sized store, the estimated revenue impact on the incumbent larger store is far smaller at around 1.6 per cent for entry within a five minute drive time. Entry by a mid-sized store does not have a statistically significant effect on incumbent larger stores beyond five minutes drive time.

*Source:* Competition Commission (2008).

To minimise the anti-competitive effects of zoning, policy makers need to ensure that areas where retailing is located are both sufficiently *large* (in terms of total retail floor space) and sufficiently *broad* (in terms of allowable uses) to allow new and innovative firms to enter local markets in a manner consistent with planning objectives. In other words, where possible, retail areas should be large enough to include a number of competitors and broad enough to ensure that the business models of these competitors are not unduly constrained (that is, the area allows a wide range of business types). Broadening the zones — for example, by limiting industrial areas to narrow high-impact industrial uses and creating broad employment zones which can include commercial, light industrial, retail and even high-density residential where appropriate — and reducing prescriptive land use conditions will free up land and make it available to its most valued uses (section 8.4).

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### **8.3 Other impacts of planning and zoning regulations on the retail industry — overseas evidence**

A number of overseas studies, outlined below, have examined the impact on the retail industry of land use regulations that restrict the establishment of new large format stores. The studies suggest that restricting the development of large stores lowers retail productivity, reduces retail employment and raises consumer prices. At the same time, overseas studies have shown that land use restrictions, by constraining the supply (and location) of appropriately zoned land, have driven up property prices.

#### **The impact on retail productivity**

Planning and zoning regulations can influence the location of retail outlets and also, at firm level, store formats. This can have an influence on retail productivity via:

- constraints on the size of the retail offer for existing stores
- constraints on new stores entering the area
- constraints on an existing retailer's ability to alter its format in response to changing technology or consumer tastes and preferences.

The OECD reviewed retail productivity (in this case labour productivity, measured by value added per employee) in member countries between 1998 and 2003. It found land use restrictions have been an important contributor to constraining productivity growth in Italy, France and Spain, where there was little or no growth, and in the United Kingdom, the Netherlands and Belgium, where growth was around 1 to 2 per cent (OECD 2007a). These countries, to varying degrees, had in place planning regulations that limited the establishment of new large format stores.

In Italy, the OECD found that strict regulation to protect small shops from the competition of large-scale outlets increased the market power of incumbents and price margins, pushing up retail prices. Italian planning and zoning regulations also prevented the entry of global retailers and discount stores and constrained supermarket growth, resulting in lower productivity and higher food prices for consumers (OECD 2007a).

Within the United Kingdom, firm turnover (entry and exit of firms) in retail and wholesale trade is low compared with other industries of the economy. The OECD suggests that this could be a factor in explaining the relatively low retail productivity in the United Kingdom (OECD 2007b). Haskel and Sadun (2009) came

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to the same conclusion when they looked at firm entry restrictions in the United Kingdom retail industry (box 8.3).

More broadly, Baily and Solow (2001) found that when comparing three countries, the United States, South Korea and the Netherlands, the degree of planning and zoning regulations on retail development affected productivity in the industry (box 8.3).

**Box 8.3 The effect of firm entry restrictions on retail productivity**

Firm entry in the United Kingdom retail industry is impeded by the ‘town-centre first’ policy which is intended to protect the vitality and viability of town centres by giving planning preference to town centre sites. Haskel and Sadun (2009) found that constraining entry of out-of-town large shops not only led larger chains to shift towards opening smaller stores, but it also had adverse consequences on productivity. Their results suggest that a fall in shop sizes is associated with a lowering of multifactor productivity (MFP) growth by about 0.4 per cent per annum, about 40 per cent of the post 1995 slowdown in UK retail MFP growth. They speculate that this slowdown might have been caused by:

- firms losing scale advantages, by moving to smaller stores
- firms losing scope advantages, if existing knowledge appropriate to managing larger stores is not perfectly substitutable with the organisational capital required for smaller stores.

Baily and Solow (2001) made labour productivity comparisons between the United States, where planning and zoning regulations on retail development are more flexible and South Korea and the Netherlands, where regulations are more stringent. They found that retail productivity growth in the United States was superior to the other two countries. For South Korea, the authors stated that ‘land use restrictions and regulations protecting small retail stores have made the further evolution of Korea’s retailing industry almost impossible until recently’ (p. 166). For the Netherlands, they suggested land use restrictions had been used to restrict growth in retail formats. These restrictions have arisen partly from environmental concerns — preserving green space — and partly from a desire to protect traditional retailers. This has affected specialty retailers, in particular, that require malls or some other way of agglomerating to attract pedestrian traffic, thereby slowing their evolution and imposing a retail productivity penalty.

Foster et al. (2002) found that productivity growth in US retailing has been largely due to the entry of new stores, rather than productivity growth in incumbent stores:

Our results show that virtually all of the productivity growth in the US retail trade sector over the 1990s is accounted for by more productive entering establishments displacing much less productive exiting establishments. (p. i)

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The clear message that emerges is that in the US retail trade sector new ways of doing business are introduced and successfully contribute to productivity growth via entry and exit. (p. 42)

Similar results were found for the Canadian retail industry for the period from 1984 to 1998, where retail productivity growth arose from firm turnover (entry and exit of firms) and the reallocation of resources from the less productive to the more productive firms (Baldwin and Gu 2008).

Overall, it would appear that stringent land use regulations are an important factor in constraining productivity growth in many countries. Countries that generally have more flexible planning systems, such as the United States, have experienced higher rates of productivity growth in retail than other countries with less flexible regulations. In short, planning and zoning regulation which restricts the location of retail outlets or store formats has a negative influence on retail productivity growth.

### **The impact on retail employment and retail prices**

Planning and zoning controls, by affecting the location of retailers and their retail format or business model, can also affect employment in the industry and the prices consumers pay.

#### *Retail employment*

Overseas studies point to entry restrictions on retail outlets lowering retail employment. In France, Bertrand and Kramarz (2002) examined the impact of entry regulations introduced in the early 1970s for large retail stores and found that restricting entry slowed down employment growth in the French retail trade industry.

In Italy, Viviano (2008) also found that more stringent planning regulation depresses employment growth in regional areas (box 8.4). In the United Kingdom, Sadun (2008) looked at the effects of planning restrictions on overall retail employment, and found that less restrictive implementation of planning regulation by local authorities (reflected in a higher number of major retail developments allowed) results in higher overall retail employment growth.

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**Box 8.4 The effect of firm entry restrictions on retail employment and retail prices in Italy**

The 1998 reform of the Italian retail trade delegated the regulation of entry of large stores to regional governments. However, regional governments differed substantially in their approach to competition. Viviano's 2008 paper focused on the effects of planning laws that were implemented in Abruzzo and Marche, two otherwise similar Italian regions which adopted very different planning policies. Abruzzo set tight restrictions on the opening of new stores and enlargement of existing large stores, while Marche did not impose substantial entry barriers, except in historical, congested and polluted areas.

Competitive pressure in Marche's retail trade industry encouraged the development of more efficient retail shops (chains of small shops owned by a single wholesaler, retail cooperatives, franchising). The results showed that retail employment in Marche increased by 0.8 percentage points more than in Abruzzo (Viviano 2008).

Liberalising entry had other beneficial effects. In those Italian regions that did not impose substantial entry barriers, inflation in food and beverages was approximately half a percentage point lower than the other regions: higher productivity coupled with lower margins resulted in lower consumer prices (Schivardi and Viviano 2011).

According to the OECD (2007a):

These natural experiments gave promising evidence of the potential gains of adopting a pro-competitive framework at the local level. However, this positive experience lasted just three years in Marche, as local governments and the region, worried about the unexpected and rapid increase in large store applications, stopped this process at the end of 2002. (p. 70)

### *Retail prices*

The overseas literature finds that planning system restrictions on the format and layout of retailers reduces economies of scale and scope that could otherwise be achieved with larger formats, resulting in increased prices of retail goods for consumers.

In the United States, Hausman and Liebttag (2005) found that non-traditional retailing outlets such as Wal-Mart — that are prevented by zoning regulations from entering certain geographic markets — charged lower prices than traditional supermarkets (box 8.5). In the United Kingdom, Griffith and Harmgart (2008) determined the effects of planning regulation on the configuration of the local retail market. They found that entry restrictions reduce the number of large supermarkets (confirming that the planning restrictions acted as a barrier to entry). They also found that restrictive planning regimes are associated with (marginally) higher food prices.

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### **Box 8.5 The effect of firm entry restrictions on US retail prices**

In the United States, Hausman and Liebtag (2005) found that non-traditional retailing outlets (supercenters, mass merchandisers and club stores) such as Wal-Mart charged lower prices than traditional supermarkets. They calculated the ratio of average prices across different types of outlets for 20 food categories. When they took an average across all of the food categories they found that non-traditional retailers have prices that are 27 per cent lower than traditional supermarkets. They concluded that:

... a significant decrease in consumer surplus arises from zoning regulations and pressure group tactics that restrict the entry and expansion of supercentres into particular geographic markets. (pp. 29-30)

One concern with this finding is that the comparisons across store formats did not account for quality or package size differences for some food products. For example, the quality of meat sold may differ across outlets or the package size available at a non-traditional outlet may be much larger than a traditional store. To address these concerns, Leibtag (2006) conducted a study using similar package sizes and more specifically defined food items — namely, dairy products and eggs — and still found a significant price effect:

Even when controlling for similar-sized packages, dairy prices are 5 to 25 per cent lower at non-traditional retailers than at traditional supermarkets. For example, skim and low-fat milk prices are consistently 5-12 per cent lower at non-traditional stores. Even more price variation exists in random-weight cheese products: a pound of Swiss cheese averaged \$4.71 at grocery stores in 2003, but just \$3.77 at non-traditional retailers and mass merchandisers. (p. iii)

### **The impact on retail property values**

US and UK evidence suggests that land use restrictions raise property prices in residential and commercial markets by constraining the quantity (and location) of available space. One of the aims of land use restrictions is to reduce externalities, for example those costs imposed on landowners by the establishment of inappropriate or incompatible land use activities in nearby properties. The ultimate effect of land use restrictions on community welfare is, however, ambiguous.

According to Giertz (1977), it is virtually impossible to discern whether the impacts of zoning on property prices come from the successful prevention of externalities or from the effects of a restricted supply of appropriately zoned land:

... the effect of zoning on property values may come either from the control of an externality or from the monopolisation of a previously competitive property market. Unfortunately, it is impossible to determine in any particular case whether one or the other factor accounts for the change, or whether both are involved. This means that studies which attempt to measure the success of zoning policies ... in terms of changes in land values must be used with caution, since often they are comparing values

determined in a competitive market before the policy was in effect with monopolistic prices after the program was implemented. (Giertz 1977, p. 51)

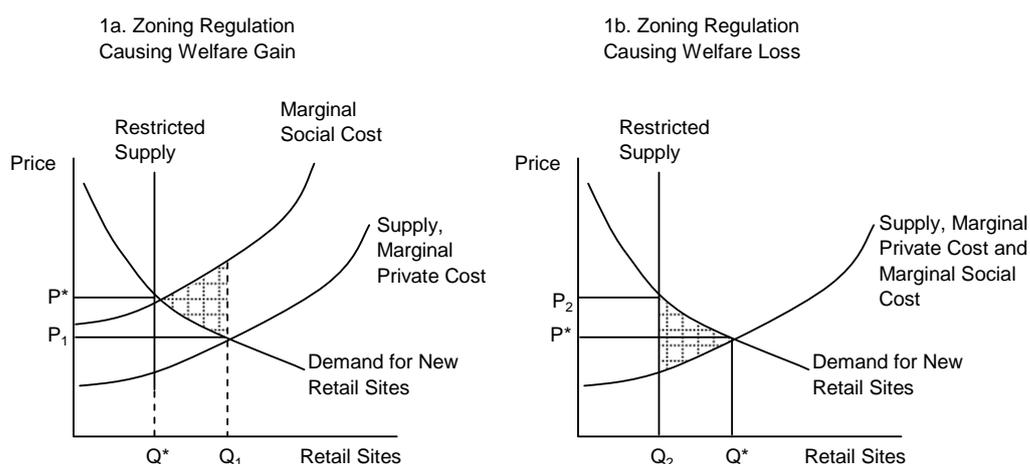
Giertz (1977) indicates that land use restrictions are only welfare enhancing if the benefits to society through resolving externalities outweigh the costs of any lessening of competition associated with the creation of monopoly market power.

### Box 8.6 Planning and zoning can cause welfare gains and losses

Planning and zoning regulation is imposed by governments to achieve welfare gains. If the social cost of an activity exceeds its private costs, regulations limiting the activity will potentially lead to welfare gains as shown in figure 1a. In an unregulated market, the number of units supplied will equate demand to marginal *private* costs. Appropriate zoning regulations, reducing supply from  $Q_1$  to  $Q^*$ , equate demand to marginal *social* costs, thereby providing a welfare gain to the community equal to the shaded area.

Alternatively, absent an externality, market actions already equate demand to marginal social costs. In this instance, as shown in figure 1b, the imposition of planning and zoning regulation reduces supply from  $Q^*$  to  $Q_2$ . This leads to a welfare loss to the community indicated by the shaded area.

Significantly, under both scenarios, restricting the supply of the available retail sites confers a benefit on incumbent property owners, as the value of their properties increase. Prices increase from  $P_1$  to  $P^*$  (figure 1a) or from  $P^*$  to  $P_2$  (figure 1b). This suggests that owners of existing properties have a private interest in restricting supply of available sites, even in the absence of external effects (which cause marginal social costs to deviate from marginal private costs).



Source: Quigley (2006).

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Box 8.6, adapted from Quigley (2006), illustrates externality zoning and monopoly zoning. Externality zoning leads to welfare gains while monopoly zoning leads to welfare losses. Significantly, under both scenarios, restricting the supply of available retail sites confers a benefit on incumbent property owners, as the value of their properties increase. This suggests that owners of existing properties have a private interest in restricting supply of available sites, even in the absence of external effects.

In other words, owners of existing retail properties can have strong incentives to ‘find’ external effects in urban land use so that restrictive actions reducing the supply of retail sites will appear to be welfare enhancing rather than welfare reducing. The confusion of externalities with the exercise of monopoly powers by incumbents need not even be a deliberate (gaming) strategy. But incumbent owners will have financial incentives to search very carefully for external costs which can justify actions to reduce the supply of available retail sites (Quigley 2006). For example, incumbent retail landlords often challenge new retail development approvals nearby using grounds of appeal such as ‘unacceptable traffic impacts’ or ‘insufficient car parking on the land’. In many, if not all cases, landlords’ underlying concerns seem to be less about retaining civic or public amenity and more about preventing or delaying the arrival of a new competitor.

While the Commission did not locate any empirical studies that specifically examined the effects on retail property values of land use restrictions, it did find a number of overseas studies that examined the effects on residential and commercial property prices of land use restrictions. These studies indicate that land use restrictions, by constraining the supply of appropriately zoned land, drive up property prices (box 8.7).

Quigley and Raphael (2005) found that in California, planning restrictions result in higher housing prices. Glaeser et al. (2005) found that prices for Manhattan apartments are more than double the cost of construction because of overly restrictive land use regulations. Cheshire and Hilber (2008) showed that office space in Britain was the most expensive in the world and suggested planning constraints were the reason for these high commercial property values. They explained these UK regulatory constraints in the following manner:

... land use regulation in the UK takes the form of universal growth constraints and growth constraints applied not just to the total area of urban land take for each city but individually to each category of land use within each city. So urban ‘envelopes’ are fixed by growth boundaries but within these envelopes the areas available for retail, offices, warehouses and industry are tightly controlled. Although not entirely inflexible, Greenbelts surrounding cities have been more or less sacrosanct since they were

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established, out of town retail is effectively prohibited,<sup>2</sup> and local planning authorities have been extremely reluctant to expand the area zoned for commercial space. (p. 186)

**Box 8.7    The effect of land use restrictions on residential and commercial property values**

Quigley and Raphael (2005) found that land use restrictions increase housing costs (in Californian cities). They showed that increased intensity of local planning restrictions has a significant impact on both the price and the supply of homes.

According to Quigley and Raphael, individual cities in California have the power to determine their own planning and approval processes because property developers are not given a default right to proceed with projects that are in compliance with existing regulations. The researchers assessed regulatory stringency for 407 Californian cities using information from a survey of land use officials based on 15 growth control measures used in California. These measures included residential restrictions that may limit building permits, requirements for 'adequate' service levels for new residential developments, ability to rezone land from residential usage, ability to reduce permitted density, and requirements for voter approval or supermajority council votes for up-zoning of land. Some cities used a combination of these measures while others used none.

By examining the relationship between regulatory measures and price indices for each city, Quigley and Raphael (2005) found that 'each additional regulatory measure was associated with a statistically significant 3 per cent (1990) and 4.5 per cent (2000) increase in prices of owner-occupied housing ...' (p. 325). They also found that these land use restrictions were associated with slower growth in the stock of residential housing.

Glaeser et al. (2005) examined Manhattan apartment prices and found that despite home building being a relatively competitive industry with few barriers to entry, prices are more than twice their supply costs. They argued that, rather than demand side factors (such as rising incomes and lower interest rates), overly restrictive land use regulations were the main reason for this gap. They also suggested that the high prices had little to do with eliminating negative externalities (such as the views destroyed by new construction or increased crowd congestion):

We can find no externality associated with new housing units in Manhattan that is remotely large enough to warrant a development tax that would make up for the current gap between construction costs and apartment prices. (Glaeser et al. 2005, p. 367)

Cheshire and Hilber (2008) found that UK planning constraints caused the average sale price of commercial property in London's West End to be eight times as large as construction costs.

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<sup>2</sup> On two different grounds: to maintain the economic strength of city centres and to reduce car use. Whether either objective is actually served by this policy and, in so far as it is, at what cost — is unclear [original text].

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Given retail property is subject to the same overarching planning rules as residential and commercial property, it is likely that the effects of planning restrictions on retail property prices, while unlikely to be of the same magnitude as these other land uses, would be in the same direction. In other words, the empirical results highlighted in box 8.7 are useful directional proxies for the impact of planning and zoning controls on domestic retail property values.

It seems that zoning places upward pressure on retail property values by constraining the supply (and location) of appropriately zoned land. While the magnitude of the price change may be debateable, the direction of the price movement is not. Increases in retail property values result from the increased rents landlords can charge retailers as a consequence of the constrained supply of retail sites. Upward pressure on rents is likely to be strongest where occupancy rates for tenancies are highest and tenants have little bargaining power vis-à-vis their landlords, that is for (non-chain) specialty retailers in shopping centres.

This assessment was echoed by a number of participants to this inquiry representing retail tenants, including the Australian Newsagent's Federation (ANF):

The ANF believes that restrictive planning laws, and the consequent effect on the supply of retail floor space, contributes to the ability of shopping centre landlords to exert significant price control over [the] respective local market for specialty retail floor space. The ultimate effect of which could be increased prices for retail goods, subject to the capacity of retail tenants to pass on costs in customer prices. (sub. 99, p. 27)

Others that make similar comments include the Australian Music Association (sub. 68), Australian Retailers Association (sub. 71), Australian National Retailers Association (sub. 91) and the National Retail Association (sub. 102). At the same time, Westfield (sub. 103) acknowledges that because of the level of state and territory planning and zoning regulation, Australia has less retail floor space per capita and higher rents than it would have otherwise (see chapter 9 for further discussion). On the other hand, the Shopping Centre Council of Australia (SCCA) (sub. 67) suggests that specific planning policies, such as activity centres policies, do not 'unduly' limit the supply of retail floor space.

## **8.4 The Australian experience with planning and zoning restrictions on competition**

In 2008, the Commission considered there was scope to increase retailing opportunities and competition in the retail tenancy market for the benefit of new

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entrants to the industry, and consumers more generally, by reducing the constraints on the supply of retail space. The Commission said:

While recognising the merits of planning and zoning controls in preserving public amenity, states and territories should examine the potential to relax those controls that limit competition and restrict retail space and its utilisation. (PC 2008c, p. xxxiv)

These laws were also discussed briefly in the ACCC's 2008 Grocery Report. According to the ACCC, restrictions created by planning and zoning laws are particularly acute for independent supermarkets. These supermarkets find it comparatively more difficult to obtain access to sites within existing shopping centres and therefore rely more heavily on the availability of new sites in an area to establish a market presence. Further, the ACCC said the complexities of planning applications, and in particular the public consultation and objections processes, while soundly based, provide the opportunity for incumbents to 'game' the planning system to frustrate or prevent potential competitors entering local markets (ACCC 2008d).

The ACCC recommended that appropriate levels of government consider ways in which planning and zoning regulation should have regard to the impacts of proposed developments on competition (ACCC 2008d).

In response to the Commission and ACCC findings, the Australian Government referred the issue to COAG's Business Regulation and Competition Working Group (BRCWG). Subsequently, on 7 December 2009, COAG made the following announcement:

To ensure a continued focus on the competitive benefits which can be secured through appropriately balanced planning and zoning systems, COAG agreed to commit to ensuring that:

- opportunities for gaming of appeal processes are minimised
- processes are in place to maintain adequate supplies of land suitable for a range of retail activities
- any unnecessary or unjustifiable protections for existing businesses from new and innovative competitors are eliminated.

Further, COAG agreed to the Productivity Commission in 2010, conducting a performance benchmarking exercise of States' and Territories' planning and zoning systems with the objective of identifying current best practice approaches to supporting competition, as well as any practices which unjustifiably restrict competition, with the terms of reference for the benchmarking exercise agreed in consultation between the Commonwealth and the States and Territories. (COAG 2009, p. 8)

The Commission's 2011 report *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments* found that planning

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guidelines on where retailers can locate are extremely complicated, and often prescriptive and exclusionary. In effect, they make it difficult for some businesses to find suitable land and enter the market, and prevent the market from allocating land to its most valued uses.

The Commission (PC 2011b) identified a number of restrictions on competition:

- narrow and highly prescriptive business zoning
- adverse impact tests on existing businesses or activity centres
- lack of ‘as of right’ developments
- business gaming of planning systems and appeal processes.

Reforming these planning and zoning restrictions would potentially increase retail competition in Australia, particularly in those areas where there is an inadequate supply of retail floor space and/or where there are planning requirements and practices which unjustifiably restrict competition.

The restrictions on competition are discussed individually below, drawing on submissions to this inquiry.

### **Narrow and highly prescriptive business zoning**

Planning and zoning regulations can serve valuable social purposes, such as: protecting property owners from expropriation of their land values by reducing the proximity of incompatible developments; and enhancing the environment and managing town and city development in a way that reduces costs to the general community (such as by reducing noise and air pollution). But they may at times also serve as a barrier to entry to retail markets by delaying, restricting, or even preventing the entry of new competitors, or unduly raising the cost of starting new business activities or expanding existing businesses in a particular area.

Striking the right balance between wider planning objectives and retail competition involves a weighing of costs and benefits to the community. However, in general, there is little to indicate that impacts on competition — or an analysis that the benefits of the desired planning outcomes have been weighed against the costs of restricted competition — are given serious consideration by governments when establishing planning and zoning regulations for the community (PC 2011b).

If there is a scarcity of appropriately zoned retail space — that is, some retail stores are excluded from the area because of insufficient space — or there are large numbers of prescriptive requirements which unjustifiably restrict competition,

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planning and zoning laws can have a harmful effect by creating local retail monopolies. The NSW Department of Planning and Infrastructure acknowledges the competition limiting effects of a lack of available retail space:

... a scarcity of appropriately zoned retail space within the central part of existing centres, and within the walking catchments of those centres, can restrict the entry of new operators and limit the extent to which existing operators can expand operations in response to increased demand — such as increased housing around the centre. (sub. DR189, p. 4)

Some retailers are concerned that planning and zoning laws are failing to ensure an adequate supply of land for retail sites in appropriate locations. Aldi remarks that this is the primary impediment to its growth in Australia:

The unavailability of sites in appropriate locations is the most significant barrier that is stalling the roll out of Aldi stores across Australia. The key issue Aldi faces ... is the unavailability of appropriately zoned and sized land. Planning policy throughout Australia seeks to locate large scale retail and commercial uses in ‘activity centres’. We understand the merits underpinning activity centres policy, however, at a basic level, planning authorities need to ensure that there is an adequate supply of land in these strategic locations. (sub. 25, p. 2)

Aldi suggests that the move towards a ‘sequential test’ approach in New South Wales and Victoria ‘is recognition that activity centres policy has failed to provide an adequate supply of land for retailers and other businesses to enter new markets’ (sub. 25, p. 2).<sup>3</sup>

While recognising that a ‘sequential test’ approach is preferable to a blanket prohibition on development outside activity centres — which would have severe implications for non-incumbent retailers if there are no available sites within activity centres — Aldi is critical of the rezoning process that, it says, in most cases ensues in Victoria:

Where an edge-of-centre or out-of-centre location is identified under the sequential test in Victoria, in our experience these sites, in the majority of instances need to be rezoned to allow retail land uses. Problematically, under the sequential test approach in Victoria, the onus is on the applicant to identify the site and demonstrate why the site should be rezoned. This approach requires applicants such as Aldi to go through a lengthy rezoning process (up to 2 years) where the outcome is highly uncertain. (sub. 25, p. 3)

In a subsequent submission responding to the Commission’s draft retail inquiry report, Aldi again highlights the unsatisfactory nature of this ad hoc approach to resolving land supply issues:

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<sup>3</sup> The sequential test approach directs that edge-of-centre locations or out-of-centre locations can be considered where there is no suitable land within activity centres.

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... Aldi considers that, in the vast majority of cases, the spot rezoning of land is not an appropriate means by which to secure a site for development. This is not only because of the lack of any right to a review of a rezoning decision but is also due to the significant time and cost penalties associated with this process. (sub. DR205, p. 6)

To overcome uncertainty and lack of timeliness with this informal approach, Aldi proposed a ‘defined sequential test’ that seeks ‘to codify net community benefit’ for local governments when assessing development applications, particularly those outside of designated activity centre boundaries (sub. DR205, p. 1). The Commission recognises that such a test would provide a consistent set of provisions to be considered by local governments in their assessments of development applications outside activity centres. However, the proposed test would not necessarily lead to a net community benefit as some of the suggested assessment criteria appear anticompetitive.

For example, Aldi suggests the assessment needs to demonstrate that ‘there is an existing unmet demand for the proposal’ and also consider the ‘demonstrated need for the development’ (sub. DR205, p. 8). These criteria seem at odds with the criterion that says ‘the likely impact of the development on the commercial viability of an individual business, including loss of trade, is not a relevant consideration’ (sub. DR205, p. 9). Under the proposed test, commercial viability of existing businesses in-centre is clearly a relevant consideration because an out-of-centre development proposal would only be permitted if there was ‘existing unmet demand’. If existing demand was being met by incumbents in-centre, no new competition in an out-of-centre location would be permitted. Under this test, it appears a new development out-of-centre would only be permitted if it did not affect the commercial viability of existing businesses within the designated activity centre boundaries.

Further, drawing on some of the other proposed assessment criteria, it seems that a new out-of-centre retail location would be unlikely to proceed if it were likely to result in an adverse impact on the extent and adequacy of existing and future facilities and services (both private and public) within the existing activity centre. As discussed later, in the Commission’s view, out-of-centre retail locations should be considered where the proposed use or development is likely to generate an overall net benefit to the community, even if there are likely to be some detrimental impacts to an existing activity centre. However, to minimise adverse outcomes on competition, such an assessment should only be undertaken during strategic plan preparation or major review — not for site specific rezoning or individual development applications. Given these concerns, it is not clear that the ‘sequential test’ advocated by Aldi would ultimately deliver better outcomes for the community than those delivered under the current rezoning arrangements.

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While Aldi continues to have concerns with the unavailability of appropriately zoned and sized activity centre land, on the other hand, SCCA claims there is no shortage of sites within activity centres. To support this conclusion, it provided evidence to the Commission's recent benchmarking inquiry of solid growth in supermarket developments in five major activity centres in Sydney, Melbourne and Brisbane since 2000. It suggests, that rather than a shortage of sites, there is a continued reluctance by some retailers to pay the market prices for the sites that are available within activity centres:

We often hear arguments such as 'all of the sites are taken up' within an activity centre as a justification for proceeding with out-of-centre development. As we noted in our second submission to the Benchmarking Study, these companies should be prepared to pay market price, amalgamate sites (and pay transaction taxes), and rezone the land, as others (including shopping centres) have to do in order to develop or expand their assets and businesses. (SCCA, sub. 67, p. 13)

Despite difficulties in making strict comparisons between and within jurisdictions, the Commission's recent benchmarking report documented the average number of zones employed by local councils in each capital city. Also, it listed the councils with the most zones and the fewest zones in each jurisdiction (table 8.4).

Zones for retailers comprise a subset of the number of zones employed by local councils. Retailer zones generally range from seven to nine zones, although there can be marked variation between local council areas across Australia. For example, Darwin in the Northern Territory has 15 retailer zones compared to Sorell in Tasmania with four retailer zones.

The Commission found that highly prescriptive zoning within activity centres led businesses to push for special considerations of their business type within activity centres or attempts to locate in out-of-centre locations or industrial zones where there are fewer land use restrictions (PC 2011b).

For example, bulky goods retailers (such as bedding, electrical, furniture, hardware and whitegoods retailers) have differentiated themselves from other retailers to the extent that 'bulky goods retailing' is defined, albeit inconsistently, in all state and territory planning schemes and commonly recognised as a separate category of retailing. As the Bulky Goods Retailers Association (BGRA) states:

Based on this separate definition, bulky goods retailing can generally locate on land that is zoned for purposes other than core retail, including lower order business/commercial and industrial zoned land. (sub. 109, p. 21)

**Table 8.4 Number of zones employed by local councils, 2009-10**

Capital city and South East Queensland (SEQ) planning areas

	<i>Average number of zones within a council area</i>	<i>Council with most zones</i>	<i>Number of zones</i>	<i>Council with fewest zones</i>	<i>Number of zones</i>
Sydney <sup>a</sup>	20	Camden	48	Leichardt	5
Melbourne	17	Casey	25	Stonnington	10
SEQ <sup>b</sup>	40	Logan	105	Somerset	10
Perth	12	Perth and Swan	22	Peppermint Grove	4
Adelaide	25	Onkaparinga	51	Walkerville	7
Hobart	17	Glenorchy	31	Kingborough	6
Canberra	There are 23 zones in the <i>Territory Plan</i> (which applies to Canberra) <sup>c</sup>				
Darwin	There are 32 zones in the <i>Northern Territory Planning Scheme</i> (which applies to Darwin) <sup>c</sup>				

<sup>a</sup> The Warringah Council plan defines 74 geographical areas (localities) in which different activities are permitted and different development assessment requirements apply. These areas have not strictly been defined as zones and so Warringah Council has not been included in this table. <sup>b</sup> This includes zones and 'area classifications'. The larger size of councils in SEQ results in more zones than the smaller local governments in other jurisdictions. <sup>c</sup> The *Territory Plan* (ACT) and *Northern Territory Planning Scheme* are the equivalent of the local planning schemes of the local councils and separate to strategic land use plans.

Source: PC (2011b).

When other retail businesses witness the differential treatment accorded to bulky goods establishments, they also question whether their particular business model should also be accorded similar treatment. The reflections of Gilmour's Pty Ltd are a case in point:

Gilmour's smallest shop requires at least 8000 pairs of shoes (compared with a 'normal' shop which might have 2000 pairs), and the stock turns are not high. To house such large stocks requires large premises — and the economics of the lower stock turns in our business mean that large premises are rarely available with zoning appropriate to footwear retailing at an economic cost. We submit that the need to carry such large stocks makes us a bulky goods business. But we are not. If footwear retailing was classified as a trade appropriate to bulky goods zoning, we could expand our business and consequently our employment and our contribution to the general revenue much more quickly than we have. (sub. 43, p. 2)

Moreover, some retailers have been able to achieve considerable competitive advantages by purchasing lower priced land outside activity centres and then successfully lobbying planners to have that land rezoned for retailing activities.

While rezoning of individual sites ('spot rezoning') increases the flexibility of a planning and zoning system for developers, it (inconsistently) affords a competitive advantage to the developer who gets windfall profits by a rezoning of land for higher

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value uses, raises efficiency and equity issues, and may open up the planning and zoning system to greater gaming and abuse. (PC 2011b, p. 340)

The wider the definition of allowable uses encompassed in a given zone, the less likely it is that land with that zoning will require rezoning in order to be put to a different use. Further, wider definitions of allowable uses also provide greater scope for the market to allocate land to its most highly valued uses, albeit within the uses allowed by the zone.

The Commission suggests that if allowable uses (particularly those relating to business definitions and/or processes) were less prescriptive, this would facilitate new and innovative businesses (retail or otherwise) to locate in existing business zones. Rezoning and other changes to local authority plans to accommodate various business models would then become unnecessary.

For most businesses (retail, commercial, service providers and some light industrial), there are few adverse impacts associated with their location decisions and therefore few planning reasons why they should not be co-located in a business zone. The NSW proposal of a single business zone applied across an entire centre with the mix of uses within a centre left to the market has the potential to be a leading practice in the area (PC 2011b, p. 352)

As the BGRA comments, a less prescriptive approach would:

... increase competition by allowing a wider range of businesses and developers to bid for the same land, better harness the market in allocating land to its most valued use, and cater much more easily for innovations in business and service delivery without requiring rezoning. (sub. 109, p. 22)

The Commission's recent benchmarking report identifies a broader business zone encompassing a mix of uses as a viable alternative to the existing arrangements:

Land use zones (and overlays) in activity centres which are less prescriptive and exclusionary to businesses ... would enable planning and zoning systems to facilitate improvements in the competitiveness of city land use. (PC 2011b, p. 352)

Only high impact industrial businesses would be located separately because of their adverse effects on other land users or because planning outcomes are improved through their location near major economic infrastructure.

Broader business zones would remove the artificial distortions created by the current planning and zoning system both within retail (general retail and bulky goods) and between retail and other businesses (such as commercial and light industrial). This would have two effects:

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- reduce the incentives for some retailers to distinguish themselves from other retailers to engender differential planning treatment and gain a competitive advantage
  - reduce the need for spot rezoning, thereby making it easier for governments to implement a consistent and coordinated approach to planning and land use.

Following the release of the Commission’s draft retail inquiry report, the Victorian Planning Minister announced reforms to widen the definition of ‘restricted retail’ zoning in the state’s planning scheme (Guy 2011). Under the proposed reforms, the Victorian Government intends to:

- widen the definition of bulky goods items to be sold at a restricted retail premise to include outdoor equipment and recreational supplies, pet supplies, home wares, baby equipment and accessories and sport, cycling and children’s play equipment
- abandon a move by the previous Government that would have resulted in bulky goods retailers being barred from setting up on land zoned for industrial purposes
- remove a restriction that means bulky goods retailers must have more than 1000 square metres of floor space, allowing bulky goods retailers to adopt smaller store formats.

While the proposed Victorian planning reforms to restricted retail premises are a step in the right direction, in the longer term there should be no distinction between different retail formats for planning purposes. In other words, general retail and bulky goods outlets should be treated the same under state and territory planning schemes — ideally, no retail format should be able to use planning and zoning regulations to gain a competitive advantage over others. In the longer term, the planning objective should be to have one ‘open zone’ or multiple-use zone where a broad variety of land uses can be considered — such as retail, commercial and even some low-impact industrial uses.

#### *Prescriptive local planning restrictions on retailers*

To meet evolving product market requirements, store formats must also be allowed to adapt. Restrictions on store formats impact on a retailer’s ability to adapt to new competition and changing consumer preferences within the market.

The Commission’s recent benchmarking report identifies that even where businesses are allowed to operate in a particular locality — because their business model is consistent with the overarching activity centre policy or zone description

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— they then face a raft of local planning restrictions. This regulatory overlap arises because the legal framework for zones is at the state and territory level, but the detailed specification of zones is at the local level.

It is recognised that at times restrictions on competition may be required to achieve the objectives of the planning system, such as public amenity or equitable access to facilities and services. This is because commercial businesses are usually focused on the private costs and benefits of a development or planning proposal and may not necessarily consider the public environmental, social or economic costs and benefits associated with their decisions. Consistent with this rationale for government intervention, Stockland suggests:

... local governments should focus on those issues with external impact (either on the community or sites) such as traffic, servicing, noise, overshadowing where such issues impact public space or adjoining site amenity. (sub. DR203, p. 3)

Nonetheless, there are large numbers of prescriptive requirements which can be found in approved council plans in some or all jurisdictions which appear to unjustifiably or needlessly restrict competition, including:

- restrictions on business type (defined retail categories) allowed in particular zones in some council plans in New South Wales, Victoria and Western Australia
- site-specific restrictions on type and size of businesses allowed
- restrictions on business numbers (maximum) for different activities
- restrictions on business size via use of floor space minimums and/or caps in all states and territories, but particularly in the ACT and some councils in Victoria and South Australia
- restrictions on business location (zones for individual retailer types)
- restrictions on business mix (floor space ratios)
- detailed specifications on aspects such as the internal fit-out of developments, landscaping, advertising signage, and the minimum provision of vehicle and bicycle parking (PC 2011b).

Many of these local restrictions limit business expansion opportunities and capacity to compete. At worst, they may even discourage or prevent some businesses from entering the market in the first place. For example, restricting competition by placing limits on the number of a type of business that can establish in a particular geographic area or activity centre can have a number of adverse consequences. Protected from localised competitive pressure, incumbent businesses have greater incentive and more opportunity to charge higher prices and/or offer a lower quality

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of service. The ACT Government's intervention has gone a step further by allocating particular commercial sites to selected retailers:

... the ACT Government undertook in May 2009 to actively pick supermarket operators for new sites (and exclude some larger operators) and to allow existing independent operators to increase the size of their stores in local centres. While the Government justified its decision on the basis of long-term competition benefits which could arise with greater diversity in supermarket ownership, the approach to achieving these benefits has been widely criticised as anti-competitive for providing government support to certain market participants over others and because of the higher than competitive grocery prices which are expected to result. (PC 2011b, p. 297)

The Australian National Retailers Association (ANRA) criticises the ACT Government's intervention, saying it artificially distorts the market structure and negatively impacts on the level of competition in the grocery retailing market in the Territory:

This policy specifically excludes some supermarket retailers from participating in nominated land releases. There is no sound competition or policy basis for this and there is a risk that this policy will actually reduce competition and increase the prices of groceries in the ACT. (sub. 91, p. 34)

The SCCA is also critical of the discriminatory nature of the ACT's supermarket planning policy:

The ACT Government's 'Supermarket Competition Policy' is effectively an anti-Woolworths and Coles policy and this has a significant impact on our members' ability to expand. One member's expansion plans are being frustrated by the Government's determination to favour a smaller supermarket chain. (sub. DR186, p. 8)

The Commission recently said the cumulative impact of all these types of restrictions on businesses is difficult to ascertain, but did draw a number of conclusions:

Such directives appear to be quite prescriptive, unnecessarily restricting entry of some businesses and affording competitive advantage to other operators, with no apparent improvement in planning outcomes. (PC 2011b, pp. 299-300)

It is not clear to the Commission what benefits communities would derive from planning guidelines which contain such prescriptive business definitions nor does it seem likely that any such benefits would outweigh the costs of foregone business activity as a result of having these restrictions. Furthermore, by being overly prescriptive, such plans are unnecessarily preventing alternative business approaches to achieve the desired planning outcomes. (PC 2011b, p. 302)

In general, commercial considerations — such as the ease of site access for restocking, the value placed by consumers on car parking facilities close to shops, the limited availability of large sites in different parts of cities and their consequent cost —

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influence the location of retailers towards outcomes which are likely to be socially beneficial and therefore do not need to also be specified in planning regulations.

This study has not been presented with evidence to suggest that planning restrictions related to business size, numbers or mix are necessary to regulate the locations of retail businesses and ample evidence to suggest that such restrictions often impact (either to benefit or prevent) on particular business approaches. (PC 2011b, pp. 306-307)

Relaxing local restrictions where they exist in local planning instruments, particularly those relating to retail business type, size, number and mix, would have a positive impact on retail competition and consumer choice.

#### RECOMMENDATION 8.1

*State, territory and local governments should (where responsible) broaden business zoning and significantly reduce prescriptive planning requirements to allow the location of all retail formats in existing business zones to ensure that competition is not needlessly restricted. In the longer term, most business types (retail or otherwise) should be able to locate in the one business zone.*

### **Adverse impact tests on existing businesses or activity centres**

Activity centres policies are based around the notion of combining all major trip-generating activities, such as retail and commercial activities, in the one location with the aim of reducing ‘unnecessary’ car use and making better use of public infrastructure such as public transport and roads. Limiting ‘non-centre’ developments reduces strain on existing infrastructure and lessens negative externalities such as traffic congestion.

One factor that many local planners consider when evaluating a retail development application is whether it will have an adverse effect on existing firms and/or activity centres (or town centres) or whether there is sufficient demand to support the new business. According to the Commission’s 2011 benchmarking report:

Most (but not all) surveyed city councils in Australia consider the costs and benefits to existing businesses and impacts on the viability of a town centre in making development assessment decisions. (PC 2011b, p. 293)

Assessing the economic impact of a development proposal on existing centres is the primary approach taken by jurisdictions to protect the viability of the centre — and reduce the perceived likelihood of ending up with a ‘dead’ town centre.

The main matters often looked at in an economic assessment are existing supply and demand for the proposal, including an analysis of the demography for the area and the financial habits of the residents; any impacts on existing businesses (particularly for larger scale proposals); and net employment impact assessment. (PC 2011b, p. 292)

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Preserving an existing centre that may generate lower net community benefits appears preferable for some jurisdictions, rather than approving an out-of-centre development that may generate higher net community benefits — to mitigate the risk of any social costs associated with ‘dead’ town centres.

But if, as a result of a new out-of-centre development, the existing centre declined, the conclusion which should be drawn would be that the community prefers the mix of services the new development is able to offer. In this respect, it is worth pointing out that the new development cannot ‘put the existing centre out of business’, but people within the community can — by withholding their patronage from the existing centre which does not provide them with what they want.

While ‘dead’ town centres are not a significant problem in Australia, ‘dead’ malls are prevalent in the United States. Westfield blames these ‘dead’ malls on the lack of planning regulation in the United States:

It is clear that a lack of planning regulation in the United States has led to an oversupply of retail space. This has led to the closure of large numbers of malls. In fact mall closures are so commonplace in the United States that a website ([www.deadmalls.com](http://www.deadmalls.com)) contains descriptions and photographs of almost 400 malls that no longer function or are severely limited in function. This is virtually unheard of in Australia. (sub. 103, p. 30)

Regulation allowing new malls to develop nearby (or out-of-centre) may only be one of a number of contributing factors to the decline of older shopping malls in the United States. For example, structural changes in the department store industry in the United States have seen some national chains go out of business, so there may be a supply shortage of anchor retailers in some areas. Consumer preferences may also be changing with some people having less time to spend driving to and walking through large malls. More generally, socio-economic decline in a mall’s surrounding population catchment area could also be a contributing factor to its demise.

Australia may not have many ‘dead’ town centres (or shopping malls), but it does have pockets of vacant retail space and inactivity in shopping precincts in many locations. It is not clear that this unproductive use of space is due to too little planning regulation. Arguably, it could be due to too much regulation — such as restrictive zoning, inflexible retail tenancy regulation and rigid heritage regulation — preventing alternative uses of the space occurring in a more timely manner.

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*What type of adverse impact tests are appropriate? When should planning authorities conduct such tests?*

While governments may have worthy intentions for introducing such adverse impact tests, such as to preserve ‘vibrant’ town centres, the practical effect of such rules is to make it more difficult for competitors to start new businesses by providing incumbents with a procedurally legitimate basis for arguing against the introduction of new entrants (OECD 2008). The Orange Grove Centre case highlights this issue and the inconsistent outcomes that can arise from different interpretations of centres policy by different levels of government (box 8.8).

**Box 8.8 Orange Grove Centre case**

The ‘Orange Grove Centre’ was a retail centre located in Warwick Farm, Sydney which commenced operation in November 2002 (one month prior to the conclusion of the public consultation period). The centre was approved by Liverpool City Council in December 2002 to operate with ‘warehouse clearance outlets’ on land zoned for industrial uses, including bulky goods.

In June 2003, the Westfield Group commenced action in the Land and Environment Court, arguing that a retail outlet operating on industrial zoned land was contrary to the Council’s local environment plan (LEP). The Council attempted to amend their LEP in December 2003 to include ‘outlet centre’ as a defined activity and retrospectively rezone the Orange Grove site. However, the Court ruled in favour of Westfield in January 2004 and ordered the closure of the Orange Grove Centre’s retail activities. The decision was upheld on appeal.

Attempts were made again in June 2004 to amend the council LEP to retrospectively validate planning approval for the Orange Grove centre. The Council’s application was rejected by the Minister in July 2004 on the grounds that the proposed variation would facilitate an ‘out-of-centre’ shopping centre which would undermine the viability of competing retail activities within Liverpool and its central business district. The majority of shops in the centre closed by August 2004.

The Orange Grove Centre was approved by Liverpool Council to reopen in March 2009 as a 225-stall weekend retail market.

*Source:* PC (2011b).

According to the OECD (2008), there are several reasons why adverse impact tests are not appropriate:

- government policy should not be directed at protecting firms from competition but rather ensuring that consumers receive the maximal benefits from competition — but exceptions are appropriate when there are compelling social interests that motivate the restriction on competition

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- competitors who have adverse effects on existing firms are exactly the ones who are likely to benefit consumers the most (because for reasons of quality or price consumers will give such firms their business)
  - adverse effects tests reflect the self-interest of existing firms and can be an indication of captured regulators
  - entrepreneurs are more likely to be good judges of whether there is sufficient demand for a new offer rather than government officials. (pp. 38-39)

Consistent with the OECD's assessment, the Commission's benchmarking report concluded:

Any consideration by development assessors of potential impacts of a business proposal on other existing businesses is, therefore, an unjustifiable protection by the regulatory system of existing businesses.

However, consideration of impacts of potential developments on existing centres may be an important aspect of city planning which justifies some of the reduction in competition resulting from such considerations. To minimise the adverse outcomes for competition, any evaluation of impacts on centres should be undertaken when plans are formulated, not when proposed developments are presented to regulators. (PC 2011b, p. 298)

Property groups Stockland (sub. 105) and Westfield (sub. 103) concurred with the Commission's benchmarking report that a proposed development's impact on the viability of an existing activity centre be undertaken during the strategic planning stage or major review, rather than in the context of specific businesses during development assessment processes.

However, the Urban Taskforce was not supportive of the Commission's stance. To meet planning objectives for activity centres, and at the same time minimise any adverse effects on competition, it is necessary to assess the impacts on existing centres as a whole without concern for the likely impacts on particular existing businesses. The Urban Taskforce suggests this is a challenging task:

In brief terms, we think it is better to avoid considering the 'viability of centres' at any point in the planning process. It is difficult to consider the issue of 'viability' of a centre without considering the ... adverse impact of competition on individual businesses. The planning system does a very poor job of assessing these matters. (sub. 81, p. 6)

In a previous submission to the Commission's benchmarking report, the Urban Taskforce said the planning system does a poor assessment job 'whether the decision is made in development assessment, zoning or strategic land use planning' (Urban Taskforce 2011, p. 49).

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The Commission's benchmarking report recognised the difficulty of separating impacts on activity centres from impacts on existing businesses, but said it was necessary if planning objectives were to be met:

While it is difficult to make an assessment of the impacts on existing centres without also measuring the likely impacts on the key existing businesses within those centres, this distinction is a necessary one if planning objectives for viable centres are to be progressed with minimal adverse effects on competition. (PC 2011b, p. 298)

In the current retail environment, where there is increasing competition from online retailers, the extent to which planning objectives can take into account the fast-paced changes of a trade-exposed retail industry is questionable. Multi-channel and online retailers may well require different shop arrangements than have previously been envisaged. Retailers wanting to compete effectively in this new environment should not face unnecessary planning restrictions which inhibit their ability to respond to the market. This has implications for excessively prescriptive local planning rules but also, increasingly, for those regulations restricting new developments with the purpose of preserving existing centres. Preventing such developments, that are perhaps more closely matched to evolving market requirements, may undermine the ability of retailers to respond to consumer preferences and hasten the decline of some existing centres — the exact outcome activity centres planning policy is aimed at preventing.

Urban Taskforce Australia makes a similar point:

In short, as access to the internet spreads, as it becomes faster, and the quality of the online purchasing experience improves, activity centre policies (that limit retail developments) will reduce the ability of traditional walk-in shops to compete with online stores.

... It is important that activity centre policies be modified so that walk-in stores are able to more closely compete with online stores in terms of convenience. This means a greater willingness to allow retailers to build and operate new stores where they assess customer demand requires it, and a greater willingness to allow new retail precincts to compete with existing precincts to avoid congestion. (sub. 81, p. 3)

Moreover, international experience confirms this view. Recent UK evidence suggests that attempting to protect town centres may lead to sub-optimal outcomes for the community. For example, Smith (2006) concluded that regulations intended to protect city centres in the United Kingdom encouraged the entry of stores that were smaller than both consumers and retailers preferred.

Sadun (2008) also found that entry regulations preventing the development of large stores in out-of-centre locations paradoxically harmed small, independent retailers within town centres — which the planning regulations were intended to protect. Box 8.9 discusses the changes to UK planning regulation that took place in the early

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and mid 1990s, which saw the top UK supermarket chains adapt their business model with perverse consequences for inner town small shops.

The continued growth of internet shopping is starting to undermine some of the locational advantages enjoyed by retailers. Accordingly, planning and zoning regulations which attempt to confer locational advantage by denying competing developments may be counterproductive. Governments should not consider the viability of existing businesses at any stage of planning, rezoning or development assessment processes. Any broader implications of a new business location on the viability of existing activity centres should be considered during strategic plan preparation or major planning scheme review, rather than in the context of specific businesses during development assessment and rezoning approval processes.

The NSW Department of Planning and Infrastructure suggests that the impacts of possible future retail locations on existing activity centre viability should also be considered during *rezoning* as ‘this ... recognises that proposals to rezone land to provide for retail development may occur outside of the preparation or ‘major review’ of a strategic plan for an area’ (sub. DR189, p. 6). As mentioned earlier, evaluation of activity centre viability during individual rezoning approval processes is likely to lead to adverse competition outcomes. Such negative outcomes for competition will be reduced if the impacts on activity centre viability of possible future business location decisions are considered during strategic plan preparation or major planning scheme review — rather than assessed on an ad hoc basis when a particular development is proposed.

Strategic planning should actively seek to forecast and make provision for future commercial land use development. Regular and timely review of strategic plans will remove the need for governments to consider the impact of individual development applications on activity centre viability.

Providing sufficient land at the strategic planning stage, with sufficiently broad uses, should enable retailers to locate in areas where they judge they can best compete — planning should be able to accommodate even the newest of current business models requiring substantial floor space. Under such conditions, a new retail location in a non-designated area should be rare. However, in this situation, consideration of public externalities such as traffic congestion and the viability of existing or planned new centres can be an important aspect of city planning which may justify accepting some reduction in competition.

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### **Box 8.9 Changes to UK planning regulation in the 1990s**

Until the late 1980s there was a relaxed government approach towards large retail stores (big-box). Firms replaced old stores in town centres with larger stores away from town centres and increased the size of many continuing stores. However, in the early 1990s planning regulation changed dramatically. The main concern driving these changes was that large and peripheral retail stores were drawing activities away from town centres, and causing their socio-economic decline. In order to sustain and enhance the vitality and viability of town centres, new entry regulations were introduced in 1993 and, more significantly, in 1996.

The new planning guidelines imposed specific entry constraints on stores in edge-of-centre or out-of-centre locations not already included in local development plans, and on all retail developments above 2500m<sup>2</sup>. The new regulations also required new out-of-town developments to comply with the 'sequential test' (that is, proof that no other central location was suitable for the new shop) and the 'test of need' (that is, that proof that the new development was needed to meet local demand conditions).

Furthermore, the planning reform required the admissibility of these new developments to be judged upon their impact on centres within their catchment area, including their effects on economic growth, employment, and the existence of local shops and services. These criteria had to be applied to all major shopping developments. Taken together, these changes meant that regulation evolved from a position in which out-of-centre development was acceptable to one in which it was seen as a last resort.

The planning change generated a significant shock to the planning system, adding non-trivial monetary and non-monetary costs to the application process. It also coincided with a stark reduction in the number of planning applications submitted for the opening of large supermarket chain stores. Instead, the larger retailers adapted to the new regulations by developing smaller chain stores, which were exempted from the new regulations. The top four UK supermarket chains grew exponentially between 1997 and 2002, while the number of large supermarkets remained constant or declined over the same period.

In many cases the smaller supermarket chain stores developed and took over inner town small independent shops. The movement towards smaller supermarket chain stores was strong enough to dramatically change the store profile of the major UK retail supermarket chains. Between 1997-98 and 2002-03, the median size of a store belonging to a major supermarket chain fell from 75 to 56 employees.

The trend towards smaller chain stores in the UK retail industry was in stark contrast to what happened in other countries. For example, over the same time period, the average store size of national retail chains in the United States — where large retail store entry is largely unregulated — increased from 142 to 152 employees.

*Sources:* Griffith and Harmgart (2008); Haskel and Sadun (2009); Sadun (2008).

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As the NSW Department of Planning and Infrastructure points out:

The viability of particular businesses should not be a matter for consideration in the planning system. The viability of existing centres and planned centres is, however, a valid consideration, given the investment of governments and the private sector in servicing existing centres with infrastructure and services not easily replicated in other locations. (sub. DR189, p. 6)

*When should an out-of-centre retail location be considered?*

An out-of-centre retail location should be considered by planning authorities where the proposed use or development is likely to generate a net benefit to the community, even if there are likely to be some detrimental impacts to an existing activity centre or to the commercial interests of individual businesses within that centre (such as likely loss of trade). Such public and private impacts can often be transient as existing activity centres (and the businesses within those centres) counter the new competition by changing their facilities, services, retail offerings and business models — that is the essence of the competitive process.

As Stockland (sub. DR203) suggests, any net community benefit test evaluating the merits of a future out-of-centre retail location — undertaken during strategic plan preparation or major review — would need to include all the likely social benefits and costs that ensue from the proposed use or development, including any negative (and positive) community impacts associated with any decline in the existing activity centre (but not existing businesses). As long as the net community benefit test is sufficiently broad, the risk of a proposed retail location having a negative impact on an activity centre that the proposed location itself cannot more than offset is likely to be small.

However, the Urban Taskforce has serious reservations about the ability of relevant planning authorities to undertake such net community benefit tests:

A planning authority will require an economic study to consider the impact of a proposed new development on the viability of existing or planned centres. This necessitates a demand and supply analysis [which requires a series of assumptions to be made].

... There is little history of planning authorities making good decisions on these commercial issues. There is no reason to believe that this is capable of changing in the future. The inherent qualities of government agencies prevent them from making good commercial judgements, and the consultancy industry that services the public sector is no substitute for actual entrepreneurs risking their own capital. (sub. DR233, pp. 7-8)

To help address such concerns, it is imperative that planning authorities supplement their own resources by engaging external parties with the requisite skills and

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experience necessary to carry out such tests in a rigorous and publicly transparent manner.

Where failed businesses in existing centres do occur — because they are not fulfilling community need, or as a result of general economic downturn or other factors — planning rules need to be sufficiently flexible to enable such centres to be revitalised, in a timely manner, by a different mix of businesses or uses. Planning processes should facilitate, not impede, such market responses. This would help to reduce the likelihood of any ongoing social costs associated with declining or ‘dead centres’, such as increased anti-social or criminal activity.

### *Future proofing of activity centres?*

Locations for future retail expansion need to be clearly identified and made transparent to the community. Adequate ‘future proofing’ of activity centres and provision for new centres during strategic planning processes could also reduce the extent to which impacts on the viability of existing centres are an issue. In existing and new development areas where provision for centre expansion can be accommodated, one option for local councils would be to avoid creating fragmented land holdings, such as strata subdivisions, in and around centres that could prevent future expansion of existing or proposed businesses (including those requiring a substantial footprint).

However, as suggested by the Urban Taskforce, this might be problematic if it prevents the development of residential (and commercial) development that involves fragmented land holdings within existing activity centres:

... the whole ‘activity centres’ concept is dependent on there being a capacity for high density residential development in the centre. The idea of the ‘activity centre’ is that people should be able to live literally on top of, or in the immediate vicinity of, retail and employment related development. This reduces the need to travel separately (by car) to access services and jobs. It boosts pedestrian activity and creates a more vibrant, people-orientated, streetscape. (sub. DR233, p. 9)

According to the Urban Taskforce, if governments sought to prevent the development of land within existing activity centres that involved the fragmentation of land holdings, it would ‘simply prevent necessary residential and commercial development from proceeding, and ultimately lead to the failure of the activity centres policy’ (sub. DR233, p. 10).

Rather than using land use restrictions to prevent the fragmentation of land holdings in the first place — that is, by preventing the creation of strata titled property in and around existing activity centres — the Urban Taskforce suggests it would be better

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to reform strata title legislation to make it easier to consolidate fragmented land holdings. It suggests this could be done by allowing, for example, owners' corporations to be wound up by a special majority vote.

In relation to greenfield activity centres, Aldi suggests that local planning authorities are failing to adequately cater for future growth:

The standard approach is to designate an area of land as an activity centre and then encircle it with periphery land uses including medium density residential development. There needs to be substantial rethink on how activity centres are planned and how they can be future-proofed to cater for inevitable and predictable growth. (sub. 25, p. 3)

According to Aldi, future proofing could be achieved by restricting the fragmentation of land in edge-of-centre locations and identifying areas for future retail/commercial development through targeted strategic planning. If this occurred, local planning authorities could then:

... take into consideration the future growth needs of the activity centre before approving long term, 'generational' type land uses, such as residential land use on the periphery of activity centres, which as we are witnessing now, creates a barrier to future expansion. (sub. 25, p. 3)

Instead of preventing fragmented landholdings in greenfield activity centres, the Urban Taskforce suggests a better approach would be to allow retailers to surround their sites with 'at-ground' (rather than underground) car parking.

This preserves a large amount of land in economic use (and while this land is relatively inexpensive, it is more cost effective than the costs of building and maintaining an underground car park). However it also ensures that as the need for retail expansion arises in the future, the site can be redeveloped with underground car parking with a greater volume of retail floor space. (sub. DR233, p. 10).

When considering future proofing, planning authorities need to carefully evaluate the costs of preventing the creation of fragmented residential and commercial landholdings in and around greenfield centres relative to the benefits of holding land, in perhaps an under-utilised manner, until a greenfield centre needs to expand.

In practice, a 'future proofing' policy could result in affected areas of an existing activity centre not being re-developed and in greenfield centres, significant tracts of land could lie idle for an extended period for lack of an economic urban use. These outcomes may not necessarily be the most efficient use of land resources for the community. The extent to which an activity centre should be future proofed will depend upon the forecasts of demand for the centre over time, which will in turn depend on the interaction of many socio-economic factors. Moreover, it may not always be possible or even desirable to future proof — especially in the case of existing activity centres. The difficult challenge for planners is to strike the right

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balance between supply and demand for an activity centre over time so the costs to the community of under/over future proofing are minimised.

RECOMMENDATION 8.2

*Governments should not consider the viability of existing businesses at any stage of planning, rezoning or development assessment processes. Impacts of possible future retail locations on existing activity centre viability (but not specific businesses) should only be considered during strategic plan preparation or major review — not for site specific rezoning or individual development applications.*

### **Lack of ‘as-of-right’ developments**

‘As-of-right’ developments (or ‘code based assessments’) are those which 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.

Aldi’s submission suggests there is a need for zones to be established that will allow the use of land for retail sites to be as-of-right:

If uniform ‘as of right’ retail zones were established for retail/shops uses, a supermarket developer such as Aldi would be able to identify sites appropriate to its requirements within the zones and know that it need only apply and obtain development approval for buildings and works to facilitate the use. Thus, the zones would establish greater certainty for small format supermarket operations as they would only be required to successfully negotiate and address the design of the development and its response to the surrounding built environment to obtain development approval from the relevant planning authority. (sub. 25, p. 4)

The Commission’s recent benchmarking report suggests that barriers to entry for new retailers would be lower in those zones where this type of development is encouraged. Such developments would be facilitated by less prescriptive business definitions in council plans. Where as-of-right development is permitted, entry into markets may be more straightforward with fewer delays and greater certainty around the right to use a site for its zoned purpose. New retail formats could locate in existing zones without necessitating changes to council plans to accommodate each variation in business model. A consequence of more as-of-right development would be reduced spot rezoning, with its inherent inefficiencies, inconsistencies, windfall gains and incentives for gaming by business competitors.

The Commission’s benchmarking report concluded that ‘Facilitation of more ‘as-of-right’ development processes for activities would reduce uncertainty for businesses and remove scope for gaming by commercial competitors’ (PC 2011b, p. 353).

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*State, territory and local governments should facilitate more as-of-right development processes to reduce business uncertainty and remove the scope for gaming by competitors.*

### **Business gaming of planning systems and appeal processes**

Planning approval processes for retail projects fall into two general categories:

- developments on land that is appropriately zoned for the purpose but nevertheless require development approval
- developments which do not fit the land use designation and/or associated development controls for that site and require a land rezoning.

Both processes are open to gaming, whereby third parties can avail themselves of objection or appeal rights in an attempt to prevent a development or at least to increase the time, costs and risk faced by a prospective competitor.

ANRA suggests that many delays are caused by an unbalanced planning system placing disproportionate weight on objections to development approvals:

Regulatory compliance costs arise when the assessment process is cumbersome and involves long delays in reaching a decision. Many of these delays are caused by the system being unbalanced and putting undue weight on objections to projects, even when projects are consistent with existing buildings and land uses. (sub. 91, p. 31)

Aldi suggests that limiting third party rights in development applications and rezoning requests is necessary to improve competition and reduce the time and cost associated with developments:

We believe there is serious merit in seeking to minimise the opportunities for non-bona fide third party involvement in development applications and rezoning requests ... in our view, planning systems in Australia provide too much scope for objectors (individual persons or businesses) to lodge objections and to seek an appeal of decisions, particularly where Aldi has applied for a permit in appropriately zoned 'as of right' land. The status quo in Australia allows competing businesses to lodge objections and to appeal decisions to frustrate the development approval (or rezoning) process. (sub. 25, pp. 4-5)

During consultations on the recent benchmarking report, most jurisdictions reported to the Commission that objections which are not based on sound planning principles would not preclude the approval of a relevant development. But often the purpose of an objection is achieved simply if a proposal is delayed through the objection

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process — any rejection of the proposal would be an added benefit. Furthermore, the planning systems in some states require that only those parties which have lodged an objection may have standing to appeal a development assessment decision. A desire to leave open the possibility for an appeal creates an additional motivation to lodge an objection.

Submissions to the Commission’s benchmarking report presented differing views with respect to the existence and extent of gaming of appeals processes. The Commission concluded the extent to which gaming of appeals occurs in each jurisdiction is likely to be related to the ease with which third party appeals can be made and the impacts that such appeals could be expected to have on competitors (PC 2011b).

The Commission suggested that third party appeals should be possible, but limited to issues which were subject to development assessment consideration — appeals on matters that were resolved during planning processes should not be considered. This would mean that third party appeals are not possible, for example, on compliant development assessments. To reduce vexatious appeals, there should also be clear identification of appellants and their reasoning for appeals (preferably based on net community benefit grounds), and the capacity for courts and tribunals to award costs against parties seen to be appealing for purposes other than planning concerns. These measures would reduce incentives to game the appeals system to intentionally slow down developments.

The Commission concluded that ‘Third party appeals which are appropriately contained in terms of the types of development assessments which can be appealed and the parties which can appeal are a highly desirable approach to enable planning systems to support competitive outcomes’ (PC 2011b, p. 354).

#### RECOMMENDATION 8.4

*State and territory governments should ensure third party appeal processes within planning systems include clear identification of appellants and their grounds for appeal and allow courts and tribunals to award costs against parties found to be appealing for purposes other than planning concerns.*

## 8.5 Planning regulation and compliance costs

Planning processes usually require development approval prior to new construction or to a change in use. These processes can create a variety of compliance costs for a new or expanding business.

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According to the Commission's benchmarking report (PC 2011b), the main compliance costs associated with development applications or when seeking planning scheme amendments (rezoning) include:

- procedural requirements such as preparing, submitting and providing impact assessments and other material to support an application
- meeting specified development controls such as location, operating hours, business format, density, amenity, environmental and heritage requirements
- fees and charges such as application or other administration fees
- charges to verify that developments accord with approved drawings
- holding costs associated with the time taken to obtain planning approval.

If such costs are comparable for *all* retailers, there may not be a discriminatory or anti-competitive effect that arises from them. However, to the extent that planning processes achieve government objectives in ways that are more costly than necessary, the planning process creates deadweight losses and can result in raising the expected costs of a development, making some developments financially unviable that would otherwise be economically worthwhile.

Overlaying these direct costs are indirect costs such as:

... uncertain and protracted timeframes; complex, inconsistent and unpredictable regulatory frameworks; and intra- and inter-jurisdictional differences in administration and regulatory processes. (PC 2011b, p. 228)

These indirect costs add to the risks and compliance burdens faced by business and non-business users of the planning system, in particular, through additional holding, legal and expert consultant costs.

Approval timeframes (and the related issue of holding costs) are a significant issue for developers. They can reflect a range of factors such as the scope and nature of approval requirements, the quality of information developers provide, referrals, public consultation, appeals and the efficiency of development assessment staff.

The costs of delay for businesses can be substantial, as noted by the OECD (2008):

The time cost of delay for a company is not simply the interest rate that it pays on borrowed funds while waiting for approval; it is the opportunity cost of its funds, which is higher than the interest rate. If the opportunity cost of money is 15 per cent per year, and planning adds 3 years to the time to opening a new site, as is possible with complex projects with appeals, the cost of delay is 52 per cent of the initial investment. (p. 36)

Of course, some of the delay costs may be unavoidable, such as those due to construction time, and others may be reduced if land is being used for alternative

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purposes during the application period (such as a fee paying car park), as opposed to lying fallow.

The Commission's recent benchmarking report suggests a number of practices could reduce compliance costs on retail businesses, including:

- providing incentives for development applications to be adequate on first submission, such as escalating penalties associated with incomplete development applications
- limiting the range of reports that must accompany an application to those essential for planning assessment, leaving the need for other reports such as for construction site management and most engineering and drainage until after planning approval is obtained
- adopting electronic development assessment/planning systems
- ensuring the skills base of local council development assessment staff includes a good understanding of the commercial implications of requests and decisions and the capacity to assess whether proposals comply with functional descriptions of zones rather than judging them against detailed prescriptive requirements
- streamlining development applications into assessment 'tracks' that correspond to the level of risk/impact and thus the level of assessment attention required to make an appropriately informed decision
- using deemed approval provisions for some development assessments taking longer than the statutory decision-making period
- using deemed approval provisions for referral agencies which fail to meet the referral time limit
- as far as technically possible, resolving referrals simultaneously rather than sequentially.

RECOMMENDATION 8.5

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

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## 9 Retail tenancy leases

### Key points

- The market for retail tenancy leases is important for retailers because occupancy costs are one of the major cost drivers for the retail industry. The main concerns raised by participants to this inquiry relate to leasing arrangements *within shopping centres*. Similar concerns were raised in the Commission's previous retail tenancy inquiry report published in 2008 and will not be re-visited in this inquiry.
- Planning and zoning regulation appears to be the root cause of many of the problems that arise in retail tenancy. Further refinements to retail tenancy regulation are unlikely to result in significant improvements to the operation of the retail tenancy market given the distortions and constraints arising from planning and zoning regulation.
- While the exact extent to which planning and zoning controls have reduced the (competitive) supply and location of retail floor space in Australia is unclear, they are likely to have had some adverse impact on the operation of the retail tenancy market by:
  - increasing retail centre development prices to a level higher than they would be otherwise
  - reducing the level of localised competition between shopping centre landlords.
- There is scope to improve the retail tenancy market by removing unnecessary restrictions on competition and constraints on the supply and location of retail space through the reforms to planning and zoning regulation discussed in chapter 8. Implementing these reforms 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 business after lease expiry.
- COAG should ensure that all current National Retail Tenancy Working Group projects are *fully* implemented. It should also re-examine the outstanding recommendations from the Commission's 2008 retail tenancy report with a view to expanding the work plan of its National Retail Tenancy Working Group.

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## 9.1 The market for retail tenancy leases

The market for retail tenancy leases is important for retailers because occupancy costs are one of the major cost drivers for bricks and mortar retailers. As the Red Group points out:

Rental costs are a significant impost for physical store operators, ranging from just over 2 per cent for JB Hi-Fi to in excess of 20 per cent for specialty retailers. (sub. 89, p. 9)

The cost of leasing retail space for a tenant is usually made up of a number of key components (box 9.1). These cost components may be ongoing or regular, may be directly related to the amount of space leased and may differ substantially in importance depending on the location of the leased space. Other costs are irregular and/or infrequent — for example, ‘lumpy’ items such as fit-out costs or ‘make good’ provisions at lease end.

Occupancy costs (per unit of lettable retail space) vary between retailers according to the location of the premises leased and the retail amenity provided. On average, occupancy costs are lower outside of shopping centres, with only rents in the ‘prime’ retail strips approaching those in shopping centres (PC 2008c).

Within shopping centres, occupancy costs can vary markedly between small and large retail (or anchor) tenants on a per square metre basis. Because of the large number of customers attracted by anchor tenants and the higher average area of space leased they have a stronger bargaining position, so rents paid per square metre are lower than those paid by smaller specialty tenants. Explaining the factors that influence retail leasing arrangements between tenants, Westfield made the following comments:

Rents per square metre paid by retailers vary based on a number of factors, even within an individual shopping centre. Major tenants, such as supermarkets and department stores pay lower rents per square metre, but they also contribute more capital to the construction of the store, take longer term leases, up to thirty years in some cases, and take much larger stores. They also offer a point of difference to the shopping centre and so have a stronger negotiating position. Major stores bring foot traffic from which speciality stores benefit. (sub. 103, p. 15)

Diversified property group Stockland (sub. 105) made similar remarks on the importance of anchor tenants to the success of a shopping centre development.

Occupancy costs also vary according to shopping centre type. Occupancy costs are higher in regional centres (centres with extensive coverage of retail needs that typically include a comprehensive department store, discount department store, supermarket and at least 100 specialty shops) compared to smaller supermarket centres on a per square metre basis.

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## Box 9.1 Key components of retail occupancy costs

### *Payments to landlords*

**Base rent:** usually expressed as a dollar amount per square metre of retail space occupied by the tenant. Base rent is fixed in the first year and increased each year of the lease by some predetermined percentage — such as CPI plus two per cent.

**Turnover rent:** a component of rent that is determined as a percentage of the tenant's turnover during a specified period. Turnover rent therefore varies with the tenant's sales performance and can increase or decrease over the period of the lease. Typically, turnover rent is a small proportion of total rental revenue.

**Variable outgoings:** expenses that can be directly or reasonably attributable to the operation, maintenance or repair of the building in which the retailer is located. Such expenses may include insurance, security, electricity, water, cleaning, garbage collection and land tax (in those jurisdictions in which the landlord can pass this expense on to tenants).

For those tenants located in shopping centres, additional variable outgoings such as fees for the centre manager, centre landscaping and maintenance of car parks and other public amenities and facilities are typically included. These expenses are often allocated to tenants on the basis of their share of the total gross lettable area in the centre.

**Marketing expenses:** expenses related to attracting customers into the business. These expenses may be higher for those businesses seeking to be a retail destination rather than being dependent on surrounding foot traffic.

For retailers in a shopping centre, a marketing or promotions levy typically covers expenditure by the centre manager on centre promotion, advertising and market research. These expenses are often allocated to centre tenants on the basis of their share of the total gross lettable space in the centre.

### *Other costs*

**Fit-out costs:** those expenses related to the preparation of the premises for retail operation. The extent of these expenses is likely to vary considerably with the requirements of each tenant and also according to any restrictions which the landlord may place on design or on the use of architects and tradespeople. For most tenants, there are further costs associated with returning the premises to a bare condition when they vacate ('make good' provisions in the lease).

**Other possible costs:** further costs associated with retail tenancy may be incurred by tenants in securing the information and advice necessary for lease renewal negotiations and in the case of shopping centre tenants, the tenant often pays some or all of such expenses.

*Source:* PC (2008c).

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The majority of concerns raised by participants to this inquiry relate to leasing arrangements, and in particular the level of occupancy costs, for retail space *within shopping centres*. Participants also expressed concerns in relation to security of tenure of retail tenancy leases, with some suggesting the current regulations are inadequate and require further strengthening. Specific tenancy concerns raised by retailers (or retail industry organisations) are listed in box 9.2.

**Box 9.2 Tenancy concerns raised by retailers**

- Large gap between rents of anchor tenants and smaller specialty retailers in shopping centres.
- Significant differences in retail rents in Australia compared to the United States.
- Reporting of turnover data in shopping centres is used to set rents at 'excessive' levels.
- Shop fit-out requirements, particularly the inability of retailers to negotiate competitive quotes for the work undertaken.
- Standard lease terms (a provision incorporated in most state and territory legislation in a bid to improve security of tenure for tenants), that are normally of five years duration, do not provide sufficient security and are insufficient to amortise capital costs.
- Limited negotiating power of retail tenants in shopping centres at the time of renegotiating a lease.
- Landlords exploiting their superior bargaining power when a lease expires by seeking 'excessive' rent increases.
- Retailers' lack of security of tenure during 'lease hold over' periods.
- Lack of publicly available information relating to shopping centre rents.

*Source:* Various submissions.

These issues were raised and considered, either specifically or more generally, by the Commission's 2008 report *The Market for Retail Tenancy Leases in Australia* (PC 2008c). This inquiry will not be re-visiting these issues. It is also worth noting that no additional issues were identified by participants to those raised and considered in 2008.

It is imperative that the retail tenancy market is operating in a way that enables retailers and landlords to have the necessary flexibility to adjust to changes in consumer preferences and general economic conditions. This would allow retailers to be in a better position to choose their preferred retail model: whether it be an operation in the managed environment of a large shopping centre; a stand-alone

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operation in a shopping strip; or perhaps outside the retail tenancy market altogether (for example, as a ‘pure play’ online retailer). It would also allow retail landlords the ability to allocate retail floor space to those tenants who value it most.

Red Group touches on some of these changing market conditions brought on by the growth of online retail:

Within each shopping centre, we suggest that developers and landlords will have to look at the mix of types and sizes of stores available for rent as retailers start looking for smaller physical footprints. This is in line with the shift for retailers to hold lower stock weights and the in-store experience shifting to browsing.

As the bricks and mortar retailer revenue model becomes increasingly challenged so will the current rental cost model. Landlords who have transparency of their tenants sales performance will need to review their rent models as retailers start to question the value of bricks and mortar stores beyond the ‘flagship’ store in key locations or hubs. (sub. 89, p. 22)

This chapter describes retail tenancy leases and how they are regulated and recent regulation review and reform activity undertaken by COAG. In addition, recent and prospective state legislative activity is outlined in appendix B. Further refinements to retail tenancy regulation, which reflect many of the symptoms of insufficient competition between landlords, are unlikely to result in significant improvements to the operation of the retail tenancy market given the distortions and constraints arising from planning and zoning regulation. Planning and zoning regulation appears to be the root cause of many of the problems that arise in retail tenancy. A discussion of its impact on the market for retail tenancy leases concludes this chapter.

## **9.2 What are retail tenancy leases and how are they regulated?**

The majority of retail businesses are covered by retail leases while a minority are covered by commercial leases and owner occupation. Retail and commercial leases are legally binding documents that define the relationship between a lessor (the landlord) and a lessee (the retail tenant).

Leases cover many matters including: parties to the lease; lettable space; rent; lease terms and conditions; relocation; redevelopment; quality and maintenance of premises; rent reviews; fit-outs; and expiry.

Retail tenancy leases differ from other commercial tenancy leases in that they are covered by specific state and territory legislation, with the exception of Tasmania,

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where a code of practice is in place. Retail tenancy legislation has been in place in Australia since the 1980s in response to concerns about bargaining power and information imbalances between shopping centre landlords and small retail tenants.

While the legislation was mainly intended to deal with the relationship between shopping centre landlords and specialty tenants, the legislation applies more widely to all landlords (large and small) offering retail tenancies and, in some cases, to ‘large’ national tenants (depending on location of the business, floor space and activity levels). ‘Bulky goods’ and ‘direct factory outlets’ are generally not covered by retail tenancy legislation. (PC 2008c, p. xviii)

Prior to the introduction of specific retail tenancy legislation, retail leases were treated under law as standard commercial leases, as occurs in other countries such as New Zealand and the United States.

### **9.3 Recent regulation review and reform activity**

Retail tenancy legislation was enacted in all states and territories between 1984 and 2004. In an attempt to improve security of tenure and reduce the uncertainties of retail tenancy leases, the legislation has been continually reviewed, amended and expanded, resulting in complex and prescriptive, and to some extent, arbitrary rules. The key areas covered by the retail tenancy legislation include: the definition of retail tenancies; security of tenure; terms of the lease; information provisions; and unconscionable conduct.

Despite the regulation put in place to improve the market for retail tenancies, concerns continued to be expressed by both retail tenants and landlords about the adequacy and extent of the regulatory arrangements. In response, in 2007, the Australian Government requested the Commission to undertake an inquiry into the market for retail tenancy leases in Australia. The Commission finalised its report in March 2008 and it was publicly released in August 2008.

The Commission did not find strong evidence that the difference in size of market participants in the retail tenancy sector was distorting the efficient operation of the market. It noted that:

Overall, the market is working reasonably well — hard bargaining and varying business fortunes should not be confused with market failure warranting government intervention to set lease terms and conditions. Generally,

- there is no convincing evidence that systemic imbalance of bargaining position exists outside of shopping centres

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- in larger shopping centres, there is stiff competition by tenants for high quality retail space and competition by landlords for the best tenants, reflected by relatively low vacancy rates and high rates of lease renewals
  - the more desirable tenants and shopping locations are able to negotiate more favourable lease terms and conditions
  - the incidence of business failure in the retail sector is not exceptional compared to other service activities
  - formal disputes are relatively few and widely dispersed both geographically and according to shopping formats. (PC 2008c, pp. xxv-xxvi)

Nevertheless, the Commission concluded there was still room to improve the regulatory framework and information provision and suggested that change should be 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. (PC 2008c, p. xxvi)

The Commission made eight specific recommendations to improve the operation of the retail tenancy market (box 9.3).

## **9.4 COAG retail tenancy reform activity**

Following the Commission's 2008 retail tenancy report, COAG requested the Small Business Ministerial Council (SBMC) commence work to improve transparency and consistency between state and territory retail tenancy regulation.

The National Retail Tenancy Working Group (NRTWG) — a working group of the SBMC — has worked on three areas consistent with the recommendations of the Commission's 2008 retail tenancy report:

- core national disclosure statement project (recommendation 3(a) in box 9.3)
- nationally consistent reporting project (recommendation 3(b) in box 9.3)
- inconsistent retail tenancy terminology between the various states and territories (recommendations 1 and 3 in box 9.3).

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**Box 9.3 Recommendations arising from the inquiry into *The Market for Retail Tenancy Leases in Australia***

1. To improve transparency and accessibility of lease information in the retail tenancy market, state and territory governments should:
  - (a) Encourage the use of simple (plain English) language in all tenancy documentation.
  - (b) Provide clear and obvious contact points for information on lease negotiation, lease registration and dispute resolution.
  - (c) Encourage a one page summary of all lease terms and conditions to be included in retail lease documentation.
2. To improve tenancy market information, state and territory government should facilitate the lodgement by market participants of a standard one page lease summary at a publicly accessible site.
3. To improve harmonisation of lease information, state and territory governments, in conjunction with the Commonwealth, should seek to improve the consistency and administration of lease information across jurisdictions in order to lower compliance costs and administration costs by:
  - (a) Encouraging the development of a national reference lease with a set of items (and terminology) to be included in all retail tenancy leases and in tenant and landlord disclosure statements.
  - (b) Instituting nationally consistent reporting by administering authorities on the incidence of tenancy enquiries, complaints and dispute resolution.
4. To lower the cost of retail tenancy disputation, the significance of jurisdictional differences in the provisions for unconscionable conduct, should be detailed by state and territory governments in conjunction with the Commonwealth, and aligned, where practicable.
5. To moderate the adversarial nature of relationships and more extreme negotiating tactics, state and territory governments in conjunction with the Commonwealth should facilitate the introduction of a voluntary national code of conduct for shopping centre leases that is enforceable by the ACCC. The code should:
  - (a) include provisions for standards of fair trading, standards of transparency, lodgement of leases, information provision and dispute resolution
  - (b) avoid intrusions on normal commercial decision making in matters such as minimum lease terms, rent levels, and availability of a new lease.
6. To remove constraints on commercial decision making, state and territory governments should remove those restrictions in retail tenancy legislation that provide no improvements in operational efficiency, compared with the broader market for commercial tenancies.
7. As unnecessarily prescriptive elements of retail tenancy legislation are removed, state and territory governments should seek, over the medium term, to establish nationally consistent model legislation for retail tenancies, available to be adopted in each jurisdiction.
8. While recognising the merits of planning and zoning controls in preserving public amenity, states and territories should examine the potential to relax those controls that limit competition and restrict retail space and its utilisation.

Source: PC (2008c).

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As discussed in chapter 7, COAG's Business Regulation and Competition Working Group (BRCWG) is responsible for progressing reforms to planning and zoning regulation (recommendation 8 in box 9.3).

In July 2009, the SBMC endorsed a core model national disclosure statement. Victoria, Queensland and New South Wales implemented this statement from 1 January 2011. However, at the time of endorsement, the SBMC noted that the 'model disclosure statement will be adopted to the extent permitted' in jurisdictions where there are legislative and administrative differences (SBMC 2009). The harmonised statement is aimed at ensuring that lessees are better informed of their rights and obligations under a tenancy agreement. In this way, it is expected that they are able to make more informed business decisions about their lease.

Due to concerns that the harmonised statement may not be adopted by all jurisdictions, the COAG Reform Council (CRC) recommended that additional milestones be included in the implementation plan to achieve the intended output of 'greater national consistency, fairness and transparency in retail tenancy markets across jurisdictions' — or risk it not being achieved (CRC 2010).

In 2010, the SBMC also established a future work plan which considered a nationally consistent data collection and reporting project. The SBMC has provided in-principle endorsement of a national data set and all jurisdictions have been encouraged to adopt the data set to the extent possible for the collection of information on retail tenancy enquiries and disputes nationally. The CRC also suggested that additional milestones be included in the implementation plan for this project (CRC 2010).

However, in its recent response to the Reform Council, COAG said that it 'considers that as current governance processes are operating effectively, the creation of additional milestones is not necessary at this stage' (COAG 2011, p. 4).

As outlined in table 9.1, the NRTWG has two projects remaining on its current work plan to be implemented (given the national disclosure statement has been partially implemented). The Department of Innovation, Industry, Science and Research (DIISR) advised the Commission that while it was envisaged that the NRTWG would progress more of the eight recommendations from the Commission's 2008 retail tenancy report, there has been no updated work plan or milestones endorsed by either COAG or the BRCWG since the 2009-10 work plan (DIISR, pers. comm., 6 May 2011).

**Table 9.1 Status of National Retail Tenancy Working Group projects**

<i>Project</i>	<i>Background</i>	<i>Status</i>
Development of a national disclosure statement	<p>Most jurisdictions require landlords to provide tenants with a disclosure statement prior to entering into a formal lease agreement. This statement provides tenant with important leasing information before contractual obligations are incurred.</p> <p>The SBMC endorsed the national disclosure statement on 29 July 2009 and on 4 December 2009 the Ministerial Council of Consumer Affairs resolved to adopt it, to the extent possible, in their respective jurisdictions.</p>	<p>The national disclosure statement was implemented through legislation from 1 January 2011 by Victoria, Queensland and New South Wales.</p>
Nationally consistent reporting	<p>New South Wales is leading this project to identify mechanisms and standards for nationally consistent reporting to each jurisdiction on the incidence of tenancy enquiries, complaints and dispute resolution.</p>	<p>New South Wales is coordinating this project on behalf of the National Retail Tenancy Working Group, developing a national data set and proceeding to implement data standards.</p>
Inconsistent retail tenancy terminology between the various states and territories	<p>This project will identify common terms to be used nationally in reference to retail tenancy leases and the simple meaning of these terms. This project involves collecting and reviewing terminology differences arising from the national disclosure statement project and nationally consistent data collection project.</p>	<p>The National Retail Tenancy Working Group is managing this project.</p>

Source: DIISR, pers. comm., 6 May 2011.

Moreover, COAG is also making a number of changes to the Ministerial Council system from 30 June 2011. As a result of these changes, the SBMC will cease to exist. It is the Commission's understanding that DIISR has advised the Prime Minister and Cabinet Transition Working Group that the NRTWG should continue to work on the harmonisation of retail tenancy leases across jurisdictions and that state officials report direct to the BRCWG.

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Westfield is critical of the time it is taking for all jurisdictions to implement the national disclosure statement and also the failure to achieve a fully harmonised statement:

The various jurisdictions have taken more than two years to agree to the content of a common lessor's disclosure statement and, so far, only NSW, Victoria and Queensland have agreed to adopt one. The agreed disclosure statement which took effect in these states on 1 January 2011 is still deficient because of peculiar state legislative requirements. A single disclosure statement, which can operate in all jurisdictions, must be achieved. (sub. 103, p. 36)

The Shopping Centre Council of Australia (sub. 67; sub. DR186) had similar comments to Westfield, highlighting that the reform remained incomplete not only because only three states have adopted the agreed disclosure statement but also because 'we still do not have a single disclosure statement which can apply in all three of those states' (sub. DR186, p. 11) — because of individual state legislative requirements. And Stockland, while endorsing the objectives of the COAG reforms, also criticised the lack of timeliness with implementation:

Stockland considers that the retail tenancy reforms will result in greater harmonisation of legislation and result in cost efficiencies through the removal of administrative and compliance costs. However, Stockland does not consider that the retail tenancy reforms are being implemented in a timely manner. By way of example, a single disclosure statement does not yet operate in all jurisdictions. (sub. 105, p. 8)

While the majority of tenancy leases in Australia are picked up by the implementation of the agreed disclosure statement in the three largest retail tenancy markets, it must be recognised that the implementation of a fully harmonised 'national' disclosure statement is not yet complete. As a consequence, the benefits in terms of greater national consistency, fairness and transparency in retail tenancy markets across all jurisdictions remain to be fully achieved.

The full implementation of this work and also the other two projects on the National Retail Tenancy Working Group's work plan (nationally consistent data collection and reporting and use of nationally consistent retail tenancy leasing terminology) should occur as soon as possible. COAG should also re-examine the outstanding recommendation from the Commission's 2008 retail tenancy report with a view to expanding the work plan of the National Retail Tenancy Working Group. Some areas where further work could be undertaken are discussed in the following section.

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

## **9.5 The impact of planning and zoning on the market for retail tenancy leases**

Retail tenancy leases negotiated between landlords and tenants are determined by supply and demand conditions in the retail tenancy market. As discussed in chapter 8, the market operates within the constraints placed on it by planning and zoning regulation — there is a regulated supply of appropriately zoned land available for retail activity.

The supply of land in urban areas for different land uses is not fixed in the medium term because it is possible for new and existing land to be rezoned for a different use. However, because land for development is highly regulated, the supply of urban land tends to respond very slowly to changing market conditions. A shortage in the supply of land for retail uses, relative to demand, is likely to increase prices of (or rents on) existing properties. As the Commission's recent benchmarking report notes:

If the supply of developable land is constrained (whether greenfield or infill) then the supply of property in commercial, industrial and housing markets is essentially fixed. The only way that the market can respond to any increase in demand is for prices of existing property to rise. (PC 2011b, pp. 100-101)

This raises the cost of doing business for retailers. Cost increases not only limit the viability of incumbent retailers, but can also adversely affect the entry of new retailers into the market. A limited supply of retail sites can also restrict the ability of existing businesses to expand within an existing market or to move into new markets and for new businesses to enter either an existing or new market.

While planning and zoning regulations can have merit in preserving public amenity and contributing to the cost-effective use of public infrastructure, their application can limit competition and erode the efficient operation of the market for retail tenancies by driving rents higher than they would be otherwise.

This assessment is consistent with the views of a number of submissions to this inquiry. In particular, the Australian Music Association (AMA) comments:

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... the AMA understand that Australia's robust planning laws — largely set at a state and local government level — have been an important factor in the fantastic amenity and lifestyle we enjoy in Australian cities and towns. However, because they act to effectively restrict supply of large format destination shopping centres, these rules also act to make our retail rents among the highest in the world. (sub. 68, p. 6)

While the exact extent to which planning and zoning controls have reduced the (competitive) supply and location of retail space in Australia is unclear, they are likely to have had some adverse impact on the efficient operation of the retail tenancy market by:

- increasing retail centre development prices to a level higher than they would be otherwise
- reducing the level of localised competition between shopping centre landlords.

Unlike shopping centres, retail shopping strips and local shopping areas do not appear to have faced the same supply constraints given that vacancy rates are generally higher in shopping strips than in capital city CBDs and the larger regional shopping centres.

As Westfield acknowledges, from the supply side, rents are a function of retail floor space:

The United States has lower rents but approximately double the floor space per capita of Australia. The United Kingdom has higher rents than Australia but about 40% less floor space per capita than Australia. Australia has taken the middle ground between the US and the UK in providing neither too much nor too little floor space (sub. 103, p. 16)

And furthermore, that retail floor space is a function of the intensity of planning and zoning regulation:

The three countries of Australia, United States and United Kingdom have varying levels of planning regulation affecting retail development.

- The United States has the least regulation and consequently has the highest level of retail floor space per capita.
- The United Kingdom has the highest level of regulation and consequently has the lowest level of floor space per capita.
- Australia has a level of regulation in between that of the United States and the United Kingdom and levels of floor space per capita are consequently in between. (sub. 103, pp. 29-30)

In other words, more restrictive planning and zoning regulation is seen as creating a less intense competitive landscape for retail floor space in Australia which, in turn,

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alleviates pressure on Australian shopping centre landlords to offer retail space on terms more favourable to their tenants.

Because they can restrict the number and use of retail sites, planning and zoning controls can confer some negotiating power on incumbent landlords (and some retail tenants), and restrict commercial opportunities for others. These restrictions can work in favour of landlords that have control of large amounts of retail space that is located at some distance from other retail space. Such restrictions can also disadvantage existing businesses that wish to gain access to additional retail space.

Where there is a large shopping centre landlord and many small existing and prospective tenants competing for limited retail space, imbalances in negotiating power are likely to exist. Large shopping centre landlords are able to offer contracts in a retail tenancy market on a 'take it or leave it' basis, in a market characterised by very low retail vacancy rates that reflect 'frictional' vacancies (arising from the short term search, negotiation and contractual process between retail tenants and landlords), rather than 'structural' vacancies (arising from the longer term mismatch between the demand for and supply of retail space). This suggests that demand for such retail space has been outstripping the regulated supply. Following the release of the draft report, several participants again expressed concern about the imbalance of power in tenancy negotiations between shopping centre landlords and small retail tenants (Noel J Cook, sub. DR153; ARA, sub. DR162; PGA, sub. DR181).

Walking away from lease negotiations is a difficult decision for some tenants in shopping centres to contemplate if comparable retail properties are not available nearby for lease. According to the Australian Retailers Association (ARA), 'walking away' is unlikely to occur because of the current constraints imposed by zoning regulation which prevent the establishment of competing shopping centres in the local area:

Retailers are forced to transact in this landlord-defined market place because there are few practicable alternatives available to them. Where a general retail shopping centre is permitted, there is invariably an exclusive zoning which excludes any further development of a competing shopping centre in a similar area. As such, the existing shopping centre is granted an effective monopoly on the marketplace for consumers wishing to shop from a shopping centre in that area. It is a false assumption to think that a shopping centre retailer can choose to relocate out onto the strip in the same area if they don't like the centre operators. Invariably, the retailer is forced to meet the shopping centre's terms because retailing from the outside strip is simply not commercially viable and any relocation will almost certainly realise the failure of that business. Shopping centres generate traffic flow, combined marketing, parking and entertainment which a local shopping strip or mall generally does not provide. For a retailer to 'exit' a shopping centre requires a change in their entire operations of the retail business and usually is not compatible with the existing retail style. (sub. 71, p. 7)

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There is scope to increase retailing opportunities and competition in the retail tenancy market by removing unnecessary restrictions on competition and reducing constraints on the supply and location of retail space through the reforms to planning and zoning regulation discussed in chapter 8. Implementing these reforms 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 business after lease expiry.

If these planning and zoning reforms were implemented, it is likely that the current levels of prescription in state and territory retail tenancy legislation could be wound back over time, as previously recommended in the Commission's 2008 retail tenancy report (recommendation 6, box 9.3). For example, retail tenancy legislation currently contains many provisions regulating the relationship between tenant and landlord which unduly impede commercial contractual arrangements. Examples of such provisions include minimum lease terms, preferential rights of lease renewal, liability attached to lease assignment and outgoing inclusions (PC 2008c).

Winding back such legislative provisions, that intrude into negotiated contractual arrangements, could occur once the planning and zoning reforms are implemented and there is evidence they are having an impact on the retail tenancy market. Less prescriptive regulation would reduce constraints to the efficient operation of the retail tenancy market and lower compliance and administrative costs for retailers, landlords and governments. Such an approach would provide the added benefit of reducing the differences that exist between the current regulation operating in the various states and territories.

In addition, it needs to be recognised that the accumulation of retail tenancy legislation that has sought to influence conduct through prescribing aspects of the landlord-tenant relationship has not been successful in improving relationships between landlords and tenants in shopping centres. This suggests that there would be merit in re-examining the proposal for an industry-developed, national code of conduct for shopping centre leases as previously recommended in the Commission's 2008 retail tenancy report (recommendation 5, box 9.3). Such a code may help to moderate the adversarial nature of relationships and also facilitate the unwinding of the prescriptive elements of the current retail tenancy legislation.

However, as the Commission previously made clear, a code should not be developed to add an additional layer of regulation on the market and should only be pursued if the current legislative arrangements are to be reformed:

Those landlords and tenants who do become signatories to the code should (while governments are relaxing constraints in retail tenancy regulation), then be exempt from the related provisions of state retail tenancy legislation. (PC 2008c, p. 262)

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For signatories to the code, dispute resolution would be governed by provisions in the code. Once the code of conduct is fully operational, restrictive provisions of state retail tenancy legislation should be repealed.

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## 10 Retail trading hours regulation

### Key points

- Restrictions on shop trading hours have varied objectives, including the opportunity for some small businesses to trade without competition from larger retailers and to reduce the need for retail employees to work outside 'traditional' working hours.
- For consumers, restrictions on trading hours impinge on consumer choice regarding when (and where) to shop, causing inconvenience and congestion costs. For retailers, there are efficiency costs and administration costs in complying with state trading regimes. But the largest costs are reserved for those retailers who are prevented from trading to the extent they would like: they forego trade to other retailers and also to other avenues of discretionary consumer spending.
- Changes in social patterns have contributed to decisions by state and territory governments to liberalise trading hours regimes over time. But for all states, some trading restrictions still remain and they continue to discriminate between retailers on the basis of products sold, size and location.
- Beyond the deregulated ACT and Northern Territory, restrictions on trading hours apply with varying levels of intensity. Western Australia, South Australia and Queensland are the most restrictive states. Some of the regulated states have also established geographic shopping districts or regional trading precincts which have created significant 'boundary' anomalies that fundamentally distort retail markets.
- Onerous and costly compliance processes have also arisen in some regulated states to allow (large) retailers to trade on restricted trading days.
- There are good reasons why trading hours in Australia should be fully deregulated:
  - increased consumer welfare benefits associated with greater convenience and product choice
  - reduced discrimination and greater competition between retailers
  - a less artificially distorted retail industry
  - potentially lower retail prices and higher retail employment.
- In today's more competitive, globalised retail trading environment, where consumers have greater access to goods from all over the world through online suppliers, there is now an even stronger imperative for retailers to not be inhibited in their ability to respond to changing consumer tastes and preferences.

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## 10.1 Why are trading hours regulated?

Legislation regulating retail trading hours has existed in Australia since around the beginning of the 20th Century. The *Early Closing Act 1898* came into operation on 1 January 1899 in Western Australia (Kelly 1986). The South Australian Government introduced similarly titled regulation in 1900. The Queensland Government did so in the *Factories and Shops Act 1900*. Similar legislation was also introduced in the remaining states around this time (Bennett 1981).

Restrictions on shop trading hours have varied objectives, including the opportunity for some small businesses to trade without competition from larger retailers and to reduce the need for retail employees to work outside ‘traditional’ working hours. This ‘political economy’ view of trading hours restrictions attributes the regulation to special interest lobbying and regulatory capture. Christian religious organisations have also argued for maintaining the sanctity of Sundays as the ‘Lord’s Day’.

The regulation of retail trading hours has also been seen as an attempt by governments to coordinate or synchronise leisure time across families, communities or nations at large (for example, on public holidays).

On the one hand, it is evidently desirable to coordinate leisure with our fellow humans; positive externalities can arise from resting or enjoying free time collectively ... At the same time, negative externalities may result from coordinated leisure or synchronised economic activity. Anyone who has visited Central Park ... on a sunny weekend can appreciate this claim. (Burda and Weil 2005, p. 2)

From this perspective, the regulation of trading hours could be regarded as an attempt to coordinate leisure and reap the positive externalities or spillover benefits which may arise from resting or enjoying free time collectively — if only for that narrow subset of Australian businesses (and their employees) that are in the retail industry and affected by regulated trading hours. As the Shop, Distributive & Allied Employees’ Association (SDA) comments:

... 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. (sub. 18, p. 5)

Dr Joellen Riley goes further, suggesting governments need to place the interests of retail employees (particularly those concerned about the erosion of family time), above the interests of retailers and consumers when considering the regulation of retail trading hours, particularly on public holidays:

The health and social well-being of people, supported by their ability to maintain some family connections, is a valuable ‘good’, to be weighed heavily in the balance against the claimed interests of the retail industry.

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... With respect, the inconvenience experienced by those in the community who *do* enjoy their weekends and public holidays off work when they cannot crawl suburban shopping malls to buy more stuff on four and [a] half days of the year out of 365, is inconsequential when compared with the inconvenience of the retail worker who misses Christmas celebrations with the family because she is called in to stack shelves and price sale items on Christmas Day for the Boxing Day sales. (sub. DR154, p. 2)

Putnam (1995) invokes the image of ‘bowling alone’ to describe the decline of communal and social activities conducted jointly with others. But in a diverse society like Australia’s, with widely different valuations of leisure (both communal and solitary leisure) it is not obvious what the socially optimal level of trading hours is, or even the distribution through the week.

Moreover, in Australia, there is no evidence that extended shopping hours will adversely impact community participation in leisure activities. In fact, limited evidence from Western Australia suggests the opposite is the case. The 1994 statutory review of the Retail Trading Hours Act, using data from the WA Ministry of Sport and Recreation, found that sport participation rates had actually increased following the introduction of Saturday afternoon trading.

It was found that the level of registered sports participation in Western Australia had grown from 226 persons per 1000 in 1984 to 372 persons per 1000 in 1993, five years after the extension of Saturday afternoon shopping. (RTAWA 2003, p. 6)

There does not appear to be any obvious relationship between the regulation of retail trading hours and the ‘health’ of communities either within Australia or overseas. As Hogbin (1983) comments:

... the integrity of other societies in which weekend [and public holiday] trading is permitted seems neither more nor less under threat than Australian society. (p. 47)

In any event, the purported benefits of any improvements in ‘social cohesion’ or ‘social capital’ resulting from such trading hours regulation need to be weighed against the costs. These costs include the impact on consumers, particularly the inconvenience of being unable to shop at locations and times better suited to their requirements.

The most notable omission in the objectives underpinning trading hours regulation are the interests of consumers. Consumer preferences or needs can no longer be ignored or downplayed. In the past consumers had few or no places to shop if retailers were closed. In the internet age they do — to the potential detriment of many ‘bricks and mortar’ retailers (and their employees), and to the vitality of shopping precincts and community life that is often the objective of trading hours regulation.

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## 10.2 What are the costs associated with regulation?

### Costs on retailers

Regulations on trading hours (either time of day or day of week) have efficiency costs. A retailer forced to close earlier than desired suffers from excess capacity, since capital investment (for example, plant and equipment) is not fully utilised. As Bennett (1981) says:

In order to maximise the gains from the economies of scale this capital needs to be as fully utilised as possible. One way of achieving this is to maintain as even flow of retail services as possible. The present regime of trading hours works against this by causing peaks and troughs in the demand for retail services. (p. 9)

Moreover, being forced to close on Sundays prevents retailers from managing their stocks better, especially those of highly perishable goods like fruit and vegetables. More produce is wasted and last minute sales are more frequent — by closing on Sundays, shops have to sell products at marked down or even below cost prices on Saturday afternoon to get rid of whatever could not last until Monday morning (Tanguay et al. 1995).

There are also additional costs to retailers who trade in all states. These retailers have to understand, comply and administer six different sets of trading hours regulations (the ACT and Northern Territory are deregulated). The costs of doing so become particularly acute around the time of gazetted public holidays. In these situations, retailers have to interrupt ‘normal’ trading arrangements and put in place different arrangements to comply with the diverse public holiday trading arrangements set down in different states, different regions and different local trading precincts across Australia. According to Woolworths:

There [are] ... significant compliance and operational costs involved for retailers interpreting and implementing the patchwork of inconsistent trading hours and public holiday laws across Australia. As an example, the additional administration tasks involved in preparing stores for the 2010 Christmas trading period (including setting staff and delivery rostering and making changes to store processes etc) have been estimated to cost Woolworths supermarkets alone approximately \$3.4 million. (sub. 110, p. 10)

Woolworths indicated a similar cost was also experienced for the 2011 Easter/Anzac Day trading period and for other public holidays and restricted trading days.

But the biggest cost on retailers who are forced to close because of the trading hours restrictions are the retail sales lost to other businesses (retail or otherwise). In

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previous decades, the main threat was from other retail stores exempt from the trading hours restrictions or alternative activities consumers could choose to undertake when shops are closed, such as attending cinemas, gambling or visiting cafes and restaurants. However, in more recent times the competitive pressure for the ‘consumer dollar’ is also coming from online retailers (both domestic and overseas) that are unencumbered by such trading hours restrictions.

The regulation of trading hours has contributed to the growth of online retailing in Australia posing a greater potential threat to local bricks and mortar retailers, particularly in those states where shopping hours are most restricted (Coles, sub. 79; Westfield, sub. 103). In other words, inconvenient trading hours for some bricks and mortar retailers have encouraged consumers to shop online. Via the internet, Australian shoppers can now shop anywhere in Australia or overseas at any time of the day and night all year round. The effect of online retailing will vary across all sections of the retail market, but clearly it has the potential to have a significant impact on some sections of the local market, for example, books, CDs, sporting goods and electronic equipment. Those bricks and mortar retailers subject to trading hours restrictions are at a significant competitive disadvantage if they have not established their own online trading capability and pursued a ‘multi-channelling’ strategy.

### **Costs on consumers**

Regulations restricting trading hours impinge on consumer choice regarding when (and where) to shop, causing inconvenience. In other words, the opportunity cost of shopping time is raised because consumers are less able to avoid scheduling shopping trips during time which could be used for activities which they value more highly (whether they be work or leisure). By narrowing the range of time available for shopping, they also force consumers to shop at the same time as everybody else — leading to greater congestion costs (Bennett 1981). In practical terms, this means that customers are more likely to experience congested car parks, traffic jams in and around retail precincts, longer queues at checkouts and more crowded retail outlets than would be the case in a deregulated environment. Jebb Holland Dimasi (2000) suggest that these congestion costs have been reduced in those jurisdictions with more liberalised trading hours:

The old style shopping patterns, involving high peaks at popular times such as Thursday evenings, Fridays and Saturday mornings, have largely disappeared, or at least have been greatly smoothed, in those states where liberal trading hours are permitted. This is much less the case however in states such as Queensland, Western Australia and South Australia, where restricted trading hours and the absence of

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Sunday trading in particular still contribute to inconvenience and inefficiencies for consumers. (Jebb Holland Dimasi 2000, p. 5)

Online retailing is contributing to reductions in the opportunity cost of shopping time and also congestion costs as more people shop from home — at least for some purchases — rather than visiting a shopping strip or centre. But given the majority of shopping is still conducted in person and is likely to remain so (particularly for food and grocery shopping), where restricted shopping hours remain they will continue to be a cause of inconvenience and congestion costs for consumers.

### **Costs on retail employees**

Finally, regulations restricting trading hours impose costs on those employees in the retail industry who either prefer to work outside of the regulated trading hours or are indifferent to working outside of these times due to the premium wage rates available to them at these times. There are also some retail employees who would choose to work weeknights, at weekends or on public holidays irrespective of whether there are higher wage rates because it suits their preferences for work and leisure times. Also, as noted by the ACTU (trans., pp. 36-56), some retail employees rely upon working outside normal business hours and receiving penalty rates of pay, as this helps boost their overall take home pay.

## **10.3 Changing social patterns have led to more liberalised trading hours in Australia**

Changes in social patterns — such as more flexible and non-traditional working hours, the growing participation of women in the workforce and growth of both dual income and single-parent households — have contributed to decisions by state and territory governments to make shopping hours more flexible over time.

Thum and Weichenreider (1997) rationalise this outcome in a paper that considers diverse consumers who differ in their earning abilities. Where a majority of families have two income earners, long opening hours become essential and the regulation of shopping hours tends to be eliminated. Two income households welcome the new opportunities offered by longer shopping hours, such as shopping at the most convenient time, searching for the lowest price or best quality, or shopping with the whole family in less crowded facilities. On the other hand, where families are mostly single income households, restricted shopping hours tend to be more long-lasting as these households have more time for day time shopping.

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The Shopping Centre Council of Australia (SCCA) suggests that ongoing retail trading restrictions are reducing the flexibility of retailers in responding to changing social patterns:

A major damage of trading hours restrictions is that they prevent the retail industry responding to changing consumer preferences. For example, the rise of the two-income family substantially restricted the ability of families to do their shopping during the week. Only gradually were restrictions lifted, first, Saturday afternoon trading and, next, Sunday trading, to accommodate the fact that families were critically time-poor during the next week and needed the weekends to be able to do family shopping. Similarly the limit of 6pm on weekday trading (now lifted in all states) damaged the food, fast food and grocery industries, in particular, because it limited the ability of working parents to do convenience shopping after work during the week. Retailers need the flexibility to respond quickly to changing consumer preferences and social trends. (sub. 67, p. 21)

One of the outcomes of deregulated trading has been to enable consumers to more easily shop at destinations they prefer. Baker (2002) provides evidence based on data collected from surveys of shopping behaviour in Australia that suggests that deregulated shopping hours have allowed more mobile and affluent (but ‘time poor’) households to shop in larger shopping centres instead of smaller local shopping strips.

Nearly all Australian states and territories have adjusted their trading hours laws over the past two decades. Many states introduced more liberalised trading hours regimes between 1996 and 2003 — particularly in response to National Competition Policy reforms — but some restrictions still remain in a number of jurisdictions. Liberalisation of trading hours also occurred in many overseas countries during recent decades (box 10.1).

Where regulations on trading hours remain they are ‘an institutionalised and rigid form of non-price competition’ — which is available to only some retailers (Bennett 1981, p. 4). Regulations on trading hours vary between and within jurisdictions, but in all cases where they are present some retailing services are exempted. Some shops are exempt by virtue of the types of goods they sell such as those deemed ‘emergency, convenience or recreation goods’. Others are exempt because they are deemed to be ‘small’ which is determined by the number of owners and employees of a shop. While some are exempt because of their location (for example, in Western Australia because they are trading in a ‘special trading precinct’ or because they are trading north of the 26<sup>th</sup> parallel). In summary, restrictions tend to discriminate between retailers on the basis of products sold, size and location.

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### Box 10.1 **Trading hours regulations in many overseas countries have been relaxed**

Over the past five decades a number of countries in the Western world have liberalised shopping hours, particularly the removal of restrictions on Sunday shopping. The trend towards freeing up Sunday trading has been most extensive in North America, but has also occurred more recently in Western Europe and New Zealand.

In the United States, since the 1960s, there has been a steady decline in the number of states that impose a general ban on Sunday trading. In 1961, 35 states had general bans, but by 1985 only 22 states still had general bans. A similar trend began in Canada in the early 1980s and continued until 1998, when Newfoundland became the last province in the country to pass some form of deregulating legislation.

In contrast, in Europe only Belgium, Luxembourg, Sweden and Spain had taken any significant steps to deregulate Sunday trading prior to the 1990s. However, over the following decade, England and Wales, the Netherlands and Finland opted to relax their restrictions on Sunday shopping.

Scotland has never had any general legislation regarding Sunday trading. This allows opening hours of larger shops to be longer than in England and Wales. Many large supermarkets remain open seven days a week with little or no adjustment of opening hours at the weekend. However, the Sunday Working (Scotland) Act 2003 prohibits shops from compelling their workers to work on Sunday.

Closer to home, New Zealand banned trading on Saturday and Sunday completely between 1945 and 1980, before moving to near full liberalisation of shop opening hours by 1990. Shops may open at any time, with the exception of all day Good Friday, Easter Sunday, Christmas Day and before 1.00pm on Anzac Day. However, some shops can open on these restricted days if they sell certain goods or provide certain services or are located in tourist resorts such as Queenstown.

*Sources:* Burda and Weil (2005); Kajalo (1997); Scuterud (2005).

Following liberalisation, the decision by retailers on when to trade is not necessarily straightforward as individual retailers must weigh up consumer preferences, staff preferences and willingness to work, their own shop opening costs and social norms and conventions when deciding on opening hours. Trading hours are fully deregulated in the ACT and the Northern Territory — retailers can choose to trade whenever they want, including on public holidays. The absence of legal restrictions on trading hours does not necessarily mean that *all* shops are open for a longer period in these jurisdictions — for example, it is not unusual for many retailers, even the major retailers, to choose to close on significant public holidays in the ACT and the Northern Territory. Nor has deregulation resulted in 24-hour, seven days a week trading for most retailers in these jurisdictions.

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As the SDA points out, in a deregulated environment some retailers may choose to trade less, rather than more:

It is significant to note that in some areas where trading hours restrictions were removed and retailers responded by extending their opening hours, they are now actually cutting back on their hours of trade.

... Where trading hours have been liberalised, many employers, especially in the discretionary spend areas, do not utilise all of the opening hours available to them. (sub. 18, p. 5)

The absence of trading hours restrictions does generally imply more flexibility and greater variability in opening hours, as retailers more closely align their opening hours with consumer demand: retailers open when there is demand for the products they sell. In essence, the Australian experience suggests deregulating shop trading hours is not about operating 24 hours a day, seven days a week but simply being able to open to meet the needs of consumers, at times when the retail outlet can also trade profitably.

But as discussed in chapter 11, some retailers have expressed concerns (albeit disputed by the SDA) that with the penalty rate regime associated with the new harmonised award, they will not be able to trade profitably at all the times demanded by consumers. Hence the actual hours that a retailer opens following deregulation may not fully satisfy the needs of consumers due to the labour costs associated with opening at certain times.

Despite this, as Kosfeld (1998) makes clear, the deregulation of shopping hours offers retailers a new competitive strategy which may allow for a more nuanced response to consumers' preferences. Recognising retailers' greater sensitivity to their preferences, consumers are also encouraged to develop a greater variety of individual needs. This leads to both supply and demand evolving in a more differentiated fashion:

Some stores will decide to stay open at night, possibly with higher prices, while others close early, thereby being able to offer lower prices. Consumers may sometimes find it easier to shop late, accepting a possibly higher price of commodities. At other instances again they will have the time to shop early and they will go for lower prices. In any case, it should be expected that there will be a coexistence of several types of stores and consumers, instead of only one. (Kosfeld 1998, p. 13)

### **But trading anomalies still remain within and between jurisdictions**

An unfortunate side effect of governments regulating trading hours is the creation of trading anomalies. Beyond the ACT and Northern Territory, restrictions on trading hours apply with varying levels of intensity, with Western Australia, South

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Australia and Queensland being the most restrictive states. Some states, such as Western Australia, South Australia, New South Wales and Queensland, have also established geographic shopping districts or regional trading precincts which are creating significant ‘boundary’ anomalies.

For example, in 2009 the WA Government expanded the boundaries of the Perth tourism precinct (now known as one of the five ‘special trading precincts’) to include a number of Perth’s inner city suburbs (Subiaco, Mt Lawley, East Perth, West Perth, North Perth, South Perth and Victoria Park). This reform allowed all shops within the extended precinct to trade on Sundays. However, the extension of the Perth precinct only took in part of the local electorate of Victoria Park, capturing one major shopping centre but excluding another. While Sunday trading is permitted at the Centro Shopping Centre, two kilometres away the Park Centre must remain closed — even though they share the same neighbourhood. Boundary anomalies fundamentally distort local retail markets. They favour some retailers over others merely because of their location relative to some artificial border line.

To the extent that restrictions on shopping hours are a source of anomalies which create disputes and animosities, they are costly to the community. As long as they exist, resources will be expended on lobbying for their removal and deciding whether or not they should be removed. As Hogbin (1983) remarked:

Ministers of the Crown, other politicians, lobbyists, lawyers, bureaucrats, teams of research consultants, as well as the protagonists to disputes must devote time to settling them. Instead of nursing society’s self-inflicted wounds, they could be employed in other activities which contribute positively to community welfare. (p. 58)

While there has been some harmonisation of trading hours for state capital cities in relation to Monday to Friday and Saturday trading for general retail stores, significant differences still remain between jurisdictions in relation to Sunday and public holiday trading (table 10.1).

On Sundays, Victoria, New South Wales, Tasmania, ACT and the Northern Territory have no restrictions for general retail stores, while Queensland allows nine hours trading (South-East Queensland area). South Australia permits trading for six hours on Sundays and in Western Australia Sunday trading is not permitted in most areas of the Perth metropolitan area, except for the ‘special trading precincts’ which can trade for six hours (table 10.1).

**Table 10.1 Trading hours restrictions for general retail stores, capital cities**

As at October 2011

<i>Jurisdiction</i>	<i>Monday to Friday</i>	<i>Saturday</i>	<i>Sunday</i>	<i>Public Holidays</i>
New South Wales	No restrictions	No restrictions	No restrictions	4.5 restricted trading days — only small shops and exempt shops can open <sup>a</sup>
Victoria	No restrictions	No restrictions	No restrictions	2.5 restricted trading days — only exempt shops can open
Queensland	8am to 9pm	8am to 5pm	9am to 6pm <sup>b</sup>	5 restricted trading days — only exempt shops can open all days and independent retail shops 2.5 days
Western Australia	8am to 9pm	8am to 5pm	Closed, except special trading precincts <sup>c</sup> which can open from 11am to 5pm	Closed, except special trading precincts can open from 8am to 5pm other than on Christmas Day, Good Friday and Anzac Day
South Australia	Until 9pm	Until 5pm	11am to 5pm, except partially exempt shops which can open from 9am to 5pm	11 restricted trading days — only exempt shops can open all days and partially exempt shops 9 days from 9am to 5pm
Tasmania	No restrictions	No restrictions	No restrictions	2.5 restricted days — only those businesses with less than 250 employees can open
ACT	No restrictions	No restrictions	No restrictions	No restrictions
Northern Territory	No restrictions	No restrictions	No restrictions	No restrictions

<sup>a</sup> Only retailers within the Sydney Trading Precinct are permitted to trade on Boxing Day so there are only 3.5 restricted trading days for those shops that are not small shops or exempt shops. Shops which are not small shops or exempt shops may only trade on a restricted day if an exemption has been granted. Shops which are closed for business are prevented from employing staff to clean, maintain or restock their stores. <sup>b</sup> South-East Queensland area only. <sup>c</sup> Special trading precincts include Armadale, Fremantle, Joondalup, Midland and Perth.

Source: Various government websites.

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Public holiday trading arrangements diverge considerably between the jurisdictions. The most onerous restrictions are found in South Australia and Western Australia, where general shop trading is not permitted on all or most public holidays (except for special trading precincts in WA). In Queensland (South-East Queensland area), general shop trading is not permitted on five public holidays and in New South Wales trading is not permitted on four and a half days. Besides the ACT and the Northern Territory which have no restrictions, Victoria and Tasmania have the least restrictive public holiday trading arrangements with trading not permitted on two and half days (table 10.1).

Because of the differences in public holiday trading arrangements between states, boundary anomalies can arise that affect towns located close to state borders. Box 10.2 discusses the negative effects on local communities that can arise from the lack of harmonisation of trading hours across state borders.

**Box 10.2 Local community impacts arising from inconsistent retail trading hours between states**

Woolworths currently operates supermarkets in Moama (NSW) and Echuca (Vic). These towns are in close proximity to one another, being located on opposite sides of the NSW–Vic border. They are also popular tourist destinations and trade strongly in holiday periods.

There is no restriction on Boxing Day trading in Victoria meaning that Woolworths' Echuca store opens on that day. In contrast, the Moama store is unable to open due to New South Wales trading regulations. For Boxing Day 2010 the Echuca store had 3829 customers and sales turnover of \$128 893 while the Moama store received no customers and registered no sales turnover.

However, when the Echuca store opened on Boxing Day in 2010 the town experienced significant congestion due to the increased number of people who came from Moama and surrounding areas to shop in that store. This is not just problematic for the Echuca store (in terms of managing the excess demand and its consequent impact on convenience, amenity and customer experience) but also for the entire community as it creates significant traffic congestion on the bridge between the two towns. To ensure appropriate traffic controls are in place, Woolworths had to engage the services of the local police to direct traffic.

*Source:* Woolworths (sub. 110 attach., p. 40).

Coles criticises the trading arrangements in South Australia where *all* public holidays are non-trading days, other than for exempt retailers (those who are allowed to trade because of the type of goods they sell, or because their shop floor area does not exceed 200 square metres):

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In 2010 South Australia had 10 non-trading days compared to three and half days in most other states. These include substitute or additional days that were declared public holidays in lieu of the actual public holidays, for example with Christmas and New Year falling on weekends. South Australia needs to reduce the number of non-trading days in line with other states and public expectations about access to shops during these busy trading periods. (sub. 79, p. 14)

The National Retail Association (NRA) also singles out South Australian public holiday trading hours restrictions for particular criticism:

The retail sector continues to be damaged in its competition with other parts of the broader leisure, hospitality and entertainment sector, by the operation in some parts of Australia of completely unnecessary trading hours restrictions. At the centre of these entirely unsustainable restrictions is the prohibition on retailers in Adelaide from trading on all public holidays. This prohibition produced absurd outcomes over the Christmas-New Year period and the Easter-Anzac Day break. (sub. 102, p. 44)

Consumers, like Matthew Hawke, also criticise South Australia's restrictive trading hours and highlight the differences in trading hours between Adelaide and Melbourne:

I firmly believe that South Australia's restrictive retail trading hours are hampering the state's ability to attract and retain interstate and international visitors and the concomitant tourist capital. I find it absurd that key retail precincts in Adelaide are necessarily shuttered on public holidays and after 6pm most days. I have heard countless anecdotes of friends, acquaintances and business people electing to leave the state on or around public holidays, ruefully justifying it with the all-too-true statement 'Adelaide is shut, but I know Melbourne will be open'. (sub. 115, p. 1)

Finally, the New South Wales trading legislation not only prevents some retailers from trading on public holidays (that is restricted days), it also prevents them from 'preparing to trade' on non-restricted days (or at non-restricted times), if that preparation takes place on a restricted day and the retailers in question do not have an exemption from the trading restrictions.

Under the recently amended section 18 of the *Retail Trading Act 2008* (the amendment was introduced in late 2010), a shop is deemed to be open on a restricted trading day 'if goods were received, or unpacked or otherwise prepared for sale at the shop, or if stocktaking was carried out in respect of goods offered or exposed for sale at the shop'. This amended provision was put in place to preserve the right of shop employees to not work on a restricted day unless the shop had an exemption under the Act.<sup>1</sup>

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<sup>1</sup> Section 13 of the Act (Staffing on restricted days) provides employees with the right to refuse work if the shop they work in is allowed to open on a restricted trading day. That is, staff must volunteer to work on a restricted trading day.

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Woolworths describes its experience with this recently amended provision, and how the New South Wales Government had to recently intervene and overrule the legislation so that consumers would not suffer detriment on Anzac Day:

This change meant that stores in NSW that could not open also had to significantly alter staffing, planning and delivery operations to minimise customer impact. The implications of this change were expected to be worse over the Easter/Anzac Day public holiday period when stores would effectively be opening at 1pm on Anzac Day with little fresh stock (such as bread or BBQ chickens ready to sell). It was only in the week before the Easter/Anzac Day period that the NSW Government agreed to exercise discretion and allow retailers to undertake necessary stock preparation tasks in closed stores over the long weekend. (sub. 110 attach., p. 43)

### **Administrative processes for seeking exemptions from trading restrictions are onerous**

One of the major problems arising from some of the regulated state trading regimes is the onerous administration processes that have developed to allow predominantly large retailers to trade on restricted trading days (box 10.3). Moreover, the experience of retailers seeking exemptions from trading restrictions can diverge dramatically between jurisdictions.

For example, in 2010 two exemptions were initially granted in New South Wales and 26 applications were refused. Interestingly, 12 applications were not dealt with as the businesses applying for the exemptions were located within the Sydney Trading Precinct and were therefore legally allowed to trade — perhaps reflecting the confusion of some retailers about their legal right to trade in certain areas. Most of the applications sought permission to trade on Boxing Day and, to a lesser extent, Easter Sunday.

However, following an application made to the Administrative Decisions Tribunal (ADT) on 17 December 2010, the Tribunal reviewed the decision to grant Kmart (located in Orange) an exemption to open on Boxing Day. As a result of the review, the ADT overturned the original decision and refused the application by Kmart to open on Boxing Day 2010. As a consequence, only one application in New South Wales was successful in seeking an exemption (Coles located in Orange).

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### **Box 10.3 Seeking an exemption to trade on a restricted day in New South Wales and South Australia**

#### *New South Wales*

The Director-General of the Department of Services, Technology and Administration may grant an exemption to a shop enabling it to trade on restricted days. In dealing with any application for an exemption, the Director-General must not grant an exemption for a shop unless satisfied that there are exceptional circumstances of the case and that it is in the public interest to grant the exemption. In considering an application, the Director-General must have regard to the following:

- (a) the nature of goods sold
- (b) the need for the shop to be kept open on the day concerned
- (c) the likely effect of the proposed exemption on the local economy, tourism and small and other businesses in the area
- (d) the likely effect of the proposed exemption on employees of, or persons working in, the shop.

An application seeking an exemption to trade on a restricted day must be made no later than 28 days before the restricted day. Any application received within 28 days of the restricted day will not be considered for that day.

All applications will be displayed for a period of at least 21 days on the departmental website. During this 21 day period, public comment is invited regarding any application received by the Department. The Director-General must have regard to any public comment received during the 21 day period. The Director-General's decision to grant or not grant an exemption is published on the departmental website.

#### *South Australia*

The Minister for Industrial Relations may grant temporary exemptions, subject to the applicant satisfying the criteria for exemption. The Minister must consider such matters as the outcome of community consultation, the requirements of tourists and the extent of prior notice of the exemption given to the public. As part of the assessment process for exemption applications, applicants are required to undertake consultations with the community, which should involve the following elements:

- public advertisements seeking comments about the proposed exemption
- local government consultations
- consultations with employees or their representatives (union)
- police consultations
- in some circumstances, advice from public transport operators (major shopping precincts only) about the impact of increased shopping hours on public transport.

Evidence of consultations and their outcomes must be provided with the application.

*Source:* NSW and SA Government websites.

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The Australian National Retailers Association (ANRA) questions the value of the New South Wales exemption process:

For Boxing Day 2010 only two stores were granted an exemption, and one of these decisions was overturned on appeal. Despite this, retailers know that the possibility of opening on Boxing Day and Easter Sunday would boost sales ... This raises the question as to why NSW bothers to operate an exemption application process if there is so little prospect of success. (sub. 91, p. 21)

On the other hand, whilst indicating that the South Australian exemption process (box 10.3) is both time consuming and costly, ANRA highlights the successful outcomes that arose for its members. At the same time, it questions why the restricted days were not made allowable trading days:

In South Australia retailers were allowed to apply to trade on additional Sundays in the lead-up to Christmas 2010. ANRA members reported that this was a time consuming and costly process but that all applications were approved. This raises the question as to why the SA Government persisted with an application system, instead of declaring the days in question allowable trading days, to avoid the cost to retailers and the public service. (sub. 91, p. 21)

It is the Commission's understanding that over 290 exemptions were granted in the lead-up to Christmas 2010 in South Australia (South Australian Government, pers. comm., 1 June 2011).

More recently Myer has been frustrated by the cumbersome nature of the South Australian exemption process which has impeded information on trading hours being disseminated to tourists and other consumers:

- In March we had to seek special permission to trade in Adelaide City when two cruise ships were scheduled to be in port on a Sunday. Inflexible and inconsistent trading hours make it hard for tourism organisers to give accurate information to tourists.
- Over the recent Easter and Anzac break, again in South Australia, our stores were forced to close for four days out of the five-day break. Our Adelaide City store was able to trade on Tuesday (the Anzac day public holiday) however this information was only clarified to retailers one week prior to the weekend.

In fact, many of the decisions on trading hours are made close to the restricted day of trade. This makes it very difficult to get access to staff and communicate the decision to customers. (sub. 88, p. 13)

As a result of trading hours regulations and exemption processes, like those found in South Australia, the Federal Department of Resources, Energy and Tourism suggests that Australia's ability to offer a world class tourism experience is being constrained:

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The current trading restrictions restrict the supply of tourism product and prevent Australia from offering a retail experience comparable with contemporary global standards. In the fiercely competitive global tourism market, consumers have the option of travelling to destinations with more liberal trading hours such as Hong Kong, Macau and Singapore. The current trading restrictions mean that Australia is unable to provide a retail tourism product comparable to that on offer in Australia's regional competitors. (sub. DR210, p. 4)

Coles and the SCCA were also critical of the process in regional Queensland where applications are made (by retailers/retailer associations) to amend Trading Hours Orders made by the Queensland Industrial Relations Commission (QIRC) (box 10.4).

**Box 10.4 Seeking an extension of trading hours for non-exempt shops in Queensland in a particular locality**

Shops not classified as independent retail shops or exempt shops are classified as non-exempt. The trading hours for non-exempt shops are regulated by the *Trading (Allowable Hours) Act 1990* and by Orders made by the Queensland Industrial Relations Commission.

The Commission has the jurisdiction to decide trading hours in excess of the minimum allowable hours. Industrial organisations or other organisations may apply to the Commission for an extension of trading hours in a particular locality or state-wide. The Commission in making its decision may consider issues such as locality, the needs of the tourist industry and the interests of the public, consumers and business. In line with this process, the Commission has approved trading on Sundays and certain public holidays in a number of areas in Queensland.

*Source:* Queensland Government website.

As a consequence, Queensland has varied trading hours for Sunday and public holiday trading for different regional areas:

In Queensland there remains a patchwork quilt of different trading hours restrictions outside the SE corner of the State. Change or removal of these restrictions is via a lengthy and costly application and hearing process with the Queensland Industrial Relations Commission. (Coles, sub. 79, p. 14)

In regional Queensland — in those areas where Sunday trading is still not permitted — trading is also not permitted on public holidays. However a process is in place — through applications made to the Queensland Industrial Relations Commission — to grant Sunday trading (and limited public holiday trading) although this procedure is costly and cumbersome. (SCCA, sub. 67, p. 19)

An assessment of the various trading hours orders made by the QIRC, following applications by various industrial organisations (but predominantly the National

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Retail Association), suggests that most applications have been granted, with only a minority being refused in the last few years (Queensland Government, pers. comm., 8 June 2011).

Nevertheless, there would appear to be significant administration and compliance costs associated with the state processes that have been put in place to allow large retailers to trade on restricted trading days. For as long as these bureaucratic processes exist, resources will be consumed by retailers trying to obtain exemptions to trade on restricted days.

## **10.4 Are there benefits to be gained from deregulating shopping hours further in Australia?**

### **Do consumers want deregulated trading hours?**

Consumer surveys have generally shown support for retail trading hours deregulation, with between 60 per cent and 70 per cent of those surveyed supporting increased trading hours for all retailers (Jebb Holland Dimasi 2000). More recently, an 'ANRA survey found that some 83 per cent of respondents felt that shops should be able to open when it is convenient for customers' (sub. 91, p. 20).

Many surveys were conducted in the late 1990s, especially in the more regulated states of Western Australia, South Australia, Tasmania (at the time) and Queensland. The results provide an insight into community desires about when people want to shop and perhaps a rejection of governments continuing to have a role in determining how, when and where people shop.

Whether the survey question or local referenda related to:

- cancelling Sunday trading (Bendigo, Victoria, 1996)<sup>2</sup>
- re-regulation of trading hours (ACT, 1996)
- a Roy Morgan survey of Adelaide residents (April 1998) of whether they would shop on Sundays
- a similar Roy Morgan survey of Perth residents (November 1998)
- an AGB McNair survey on Sunday Trading in Queensland (June 1996)
- consumer research on support for deregulation of retail trading hours in Tasmania (March 2000)

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<sup>2</sup> The City of Bendigo, Victoria, in response to small retailer calls for the re-introduction of regulation, held a referendum that achieved a very high (non-compulsory) participation level, with 77 per cent of voters rejecting a return to regulation and the loss of Sunday trading.

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the results showed consistent majority consumer support either for rolling back re-regulation, not proceeding with re-regulation, or support for retail trading hours deregulation. (Access Economics 2003, p. 16)

An exception to these results occurred in February 2005, when the Western Australian Government conducted a referendum on whether to extend trading hours. In the referendum, voters were asked to assess separately whether the Western Australian community would benefit if general retail trading hours in the Perth metropolitan area were extended to allow trading until 9.00pm on weeknights, and for six hours on Sundays. In the referendum, 58 per cent of voters supported the ‘No’ case on the issue of extended weeknight trading and 61 per cent of voters supported the ‘No’ case on the issue of Sunday trading.

The SDA suggests the Commission underplayed the WA referendum result in its draft report:

This result appears to have been dismissed as unimportant as there was a campaign by independent grocers. Such a dismissal trivialises the voices expressed by the WA population. The WA population had a direct vote on when they wanted shops to open. There can be no more accurate reflection on community views than a referendum. (sub. DR183, p. 19)

It appears the WA Government no longer considers the 2005 referendum result to be an accurate reflection of contemporary community views because trading hours liberalisation is currently being implemented — with some bipartisan political support. After a lull in reform activity following the referendum, the WA Government has more recently adopted an incremental approach to retail trading hours reform in the Perth metropolitan area. Or in the Government’s words, it is ‘progressively simplifying the regime regulating trading hours’ (Western Australian Government 2010b, p. 10) (box 10.5).

In explaining the reasons for one (Joondalup special trading precinct) of the series of moderate steps it has taken in recent years to free up trading hours, the WA Government indicated that it is:

... taking account of changes that have come about in urban lifestyles and working hours in the metropolitan area in recent years — especially those of young families and working couples. The government has taken a modern, contemporary approach that recognises that many families and individuals require extended shopping hours to provide them with the flexibility to shop around busy working and personal lives. (Western Australian Government 2010a, p. 5839a)

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### Box 10.5 Recent reforms to trading hours by the WA Government

- January 2010, expanded the boundaries of the Perth tourism precincts to include a number of Perth's inner city suburbs (Subiaco, Mt Lawley, East Perth, West Perth, North Perth, South Perth and Victoria Park) and also extended the trading hours of the Perth and Fremantle tourism precincts to 9.00pm on weekdays — although the existing hours for Saturdays (8.00am to 5.00pm) and Sundays (11.00am to 5.00pm) remained the same.
- July 2010, renamed the existing Perth and Fremantle tourism precincts as 'special trading precincts'. Special trading precincts can trade from 8.00am to 9.00pm on weekdays, 8.00am to 5.00pm on Saturdays and from 11.00am to 5.00pm on Sundays.
- September 2010, created a new special trading precinct in Joondalup (within the Perth metropolitan area).
- October 2010, released a discussion paper that considered options to allow Sunday trading in certain whitegoods and other bulky goods or durable consumer goods throughout the Perth metropolitan area.
- November 2010, created two more special trading precincts in Armadale and Midland (within the Perth metropolitan area). Also allowed general retail shops in the whole of the Perth metropolitan area to remain open until 9.00pm each weeknight.
- February 2011, the WA Commerce Minister announced the WA Liberal Party would go to the next election with a policy of full deregulation within the Perth metropolitan area.
- September 2011, the WA Government changed the definition of 'small retail shops'. Following the change the number of people that shops classified as 'small retail shops' will be permitted to have working at any one time will increase from 13 to 18. This will allow an additional 7000 existing businesses to trade without restrictions on opening hours. The staff cap was last increased from 10 to 13 in 2006.

*Source:* Various WA Government media statements and newspaper articles.

However, this incremental approach to reform has not insulated the government from ongoing criticism, particularly from business organisations. For example, in response to the government's announcement of the latest change, increasing staff numbers allowed in those shops classified as 'small retail shops' — which are allowed to trade at anytime) — Western Australia's peak business lobby group said state government 'tinkering' with retail trading laws is just 'frustrating retailers and confusing shoppers' (WA today 2011).

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## Do consumers shop in the deregulated times after retail trading hours deregulation?

There is evidence that consumer behaviour changes after trading hours liberalisation, confirming consumer survey preferences. When given the freedom to do so, consumers actually shift their shopping patterns towards the deregulated trading hours. For example, in those states where Sunday trading has been introduced, it has been found to quickly become one of the most important trading days.

Research undertaken by Grey Advertising together with Brian Sweeney & Associates and published as 'Eye on Australia' in 1996 showed how popular shopping in supermarkets is *after 6.00pm* where the restrictions on shopping hours are removed (or reduced). Between 43 and 44 per cent of Melbourne and Sydney consumers shopped for groceries after that time in comparison with Perth where the figure was only 11 per cent (RTAWA 2003).

The ability to shop *on Sundays* is also greatly valued by consumers in those regions of Australia that allow unrestricted (or less restricted trading). In 1997, 'Eye on Australia' showed that between 33 and 35 per cent of Melbourne and Sydney consumers shopped for groceries on Sundays in comparison to only 7 per cent in Brisbane and 8 per cent in Perth and Adelaide (Jebb Holland and Dimasi 2000).

The ability to open later in the evening is of more importance to grocery shoppers and supermarkets than personal needs shoppers and general merchandise and non-food specialty retailers — where weekend shopping time is more important.

In those states and territories that have given consumers and business the freedom to interact without regulatory intervention, Sunday is now the second most important trading day after Saturday for most general merchandise and non-food specialty retailers. Research commissioned by the Retail Traders' Association of Western Australia in December 2001 and carried out by Australian Community Research (ACR), revealed that when asked if shopping centres were to open seven days a week, which would be respondents' preferred day to shop for personal items, 20 per cent indicated Sunday, second only to Saturday (29 per cent) (RTAWA 2003).

In further support for the suggestion that the regulation of trading hours reduces consumer welfare, the following evidence was provided to Tasmania's Shop Trading Hours Review Group in 2000:

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- Coles Myer reported that average Sunday turnover as a percentage of total weekly turnover in Coles Supermarkets in Victoria increased from 1 per cent in 1996 to 12 per cent in 1998 after the introduction of Sunday trading.
  - Coles Myer also reported average Sunday turnover as a percentage of total weekly turnover in Kmart stores in Victoria accounted for 18 per cent in 1998, making it the most important trading day in sales terms, despite the fact that Kmart stores only traded for seven hours on Sundays (Workplace Standards Tasmania 2000).

Restricted shopping hours inconvenience consumers, preventing them from purchasing retail goods at shopping times they prefer. When shopping hours are liberalised consumers' purchases more closely reflect their preferences, increasing consumer welfare.

### **Does retail turnover increase following deregulation of retail trading hours?**

If the retail trading hours distortion in consumer spending patterns is significant, it might be expected that removal of the distortion would see a redirection of consumer spending away from other areas and towards retail trade. This would be the case if the regulation distorts consumer choice and diverts consumer spending to other less regulated activities. This effect, if it exists, is likely to be more pronounced for discretionary general merchandise and non-food spending rather than spending in grocery stores and supermarkets.

Access Economics (2003) tested this hypothesis for New South Wales, Victoria and the ACT (the 'deregulated' states/territories) and found that there was some (weak) evidence of regulation distorting retail trade to other activities. It concluded:

There is some evidence that regulated trading hours might distort consumer spending away from retail trade to other activities. The evidence is weak, possibly mainly because of measurement problems. In particular, it is very difficult to control for the many other factors influencing retail turnover; and the long period of phasing-in that has been typical of retail trading hour deregulation in NSW, Victoria and the ACT has made isolating its effects even more difficult. (p. 30)

Box 10.6 examines why testing for retail distortions is complicated by the liberalisation approach of New South Wales, Victoria and the ACT.

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### **Box 10.6 Measuring effects of deregulation complicated by long phase in periods**

New South Wales moved to a more deregulated footing from the late 1980s, but there was no change in legislation. Instead 'technical breaches' have been allowed to accumulate without penalty. In effect, liberalisation of retail trading hours has been achieved by progressively broader non-observance of the relevant legislation from around early 1988. Because there was no sharp break from a regulated to a less regulated regime, observing any shift up in New South Wales retail turnover relative to the rest of Australia is difficult.

Similar difficulties apply in Victoria. The liberalisation sequence in that state was roughly as follows:

- Saturday afternoon trading in 1987.
- Ten Sundays per financial year allowed in 1991.
- Melbourne CBD hours effectively deregulated in 1992.
- Specified tourist precincts (outside Melbourne) granted Sunday trading in 1993.
- Effective deregulation (December 1996).

Again, observing any surge in growth of retail turnover for Victoria is difficult.

Finally, for the ACT, there was also some phasing in, plus a brief period of re-regulation, that complicates attempts at observing any retail turnover increases.

- For some years prior to the last quarter of 1996, the ACT had an 'effectively deregulated' environment.
- In the last quarter of 1996, the ACT Government placed restrictions on the trading hours of large supermarkets in the town centres and city centre.
- This was reversed in June 1997 and at that time trading hours were fully deregulated.

*Source: Access Economics (2003).*

The retail turnover results described by Access Economics are consistent with the modelling results of Brooker and King (1997). They show that the deregulation of retail trading hours in Australia would lead to higher retail volumes. This is because costs to consumers are lower under deregulation when the added convenience of longer opening times are taken into account in assessing the overall costs of shopping for consumers. These reduced costs include the lower opportunity cost of the time involved in shopping when it is convenient to the consumer, involving less conflict with other potential activities they may wish to pursue (box 10.7).

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### Box 10.7 **Modelling the effects of deregulation of trading hours in Australia**

Brooker and King examine the effects of the deregulation of shop trading hours on Australian retail sales, employment, prices and investment. An empirical model of the Australian retailing sector is constructed and used to generate estimates of the gains to consumers as well as the broader economic impact of longer trading hours.

The model suggests that a 7.5 per cent increase in trading hours following deregulation across Australia would reduce retail prices faced by consumers by 0.6 per cent — after allowing for the associated decline in shopping costs. This represents a net benefit to consumers in terms of increased convenience valued at about \$1.2 billion, or \$65 per capita per annum. The gain to consumers is larger when the reduction in shopping costs is greater and when retailers have more scope to rearrange, rather than lengthen, trading hours.

Deregulation would also boost demand for retail goods by 0.6 per cent and raise retail employment around 2 per cent which translated into 25 000 additional jobs in 1996 nationwide. Of this employment gain, 1.3 percentage points is assumed to be directly attributable to the need to employ staff to stay open longer. The remainder reflects the increased demand for retail goods.

Since retail production rises by 0.6 per cent compared to 2 per cent for employment, observed labour productivity in the retail sector declines by around 1.4 per cent in the long run. However, observed retail gross product does not include the convenience element to consumers of longer trading hours.

*Source:* Brooker and King (1997).

SCCA's assessment of the effects of liberalisation of trading hours on retail turnover is consistent with the empirical and modelling results conducted in Australia:

Experience in all states that have liberalised or deregulated trading hours has shown that household spending that previously 'escaped' to other forms of economic activity (which were not restricted in when they could operate) returns to retailing. (sub. 67, p. 22)

The Bulky Goods Retailers Association (BGRA) provided some anecdotal evidence that some of its members recorded sales increases of 5-10 per cent following the introduction of more liberalised trading hours in South Australia:

The data shows that these retailers recorded sales increases in South Australia of 5-10% more than in the balance of Australia in the twelve months after the introduction of extended hours trading in South Australia in late October 2003. Such an increase is consistent with the experience in Victoria after the introduction of extended trading hours in that state in 1996. (sub. 109, p. 25)

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Westfield (and SCCA) also submitted anecdotal evidence that suggested consumer spending is diverted to non-retail expenditure, rather than deferred, where shop trading hours are constrained by regulation:

Westfield has analysed the effect of the number of trading days on total retail sales in its centres. The analysis, which is cited in the SCCA submission, demonstrated that money not spent on days when shops are closed does not come back into stores on other days. The expenditure is lost to retailers, who are deprived of the ability to compete with other beneficiaries of consumer expenditure.

Westfield compared a major shopping centre in Adelaide to a similar centre in Brisbane. The analysis revealed that over the two months of July and August, when there were an identical number of days traded, the turnover in the Brisbane centre was just 3% higher than the Adelaide centre. However, over the December to January period later that year, where the Brisbane centre was open for three days more, sales in the Brisbane centre were 14% higher than the Adelaide centre.

More recently, Westfield has observed that the performance of its centres in Western Australia and South Australia over the combined March and April period was weaker than other states where opening hours were less restricted. (sub. 103, p. 33)

The overseas literature is consistent with the Australian evidence discussed above. Burda (2000) develops a model which demonstrates that restrictions on trading hours will in general have a negative effect on sales. This theoretical result is consistent with the empirical study conducted by Sweden's Civildepartement. It found that Sweden's retail sales turnover rose by 5 per cent as a result of the liberalisation of trading hours (Pilat 1997).

The empirical evidence does not appear to support the view of some participants, such as the SDA (sub. DR183), that consumers react to longer shopping hours by spreading the same amount of spending over a longer time period. In other words, consumers do not just have a 'lump of purchasing power' allocated to retail expenditure irrespective of the shopping time interval. When provided with more shopping hours, consumers spend more within the retail industry.

*Where there are restricted trading hours some retail expenditure is diverted to other modes of retail activity*

The substitution of telemarketing, catalogue sales, and other modes of activity for traditional 'bricks and mortar' retail spending is also common in countries where retail trading hours are tightly regulated. For example, Burda (2000) found the proportion of total German retail sales accounted for by mail-order and teleshopping was 5.4 per cent in 1993, compared to around 2.0 per cent in less regulated or deregulated countries such as the United Kingdom, Sweden and the United States.

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More recently, in Australia it appears there may have been some substitution of online retailing for traditional retailing where shopping hours are restricted. For example, Coles recently introduced the delivery of groceries purchased online on Sundays. The Sunday service was launched in August 2011 and more than 20 000 product lines are available for home delivery, including fresh produce and deli items (The West Australian 2011). According to Coles:

Coles Online has greater penetration in Western Australia and South Australia where retail trading hours are more restrictive than other jurisdictions. (sub. 79, p. 16)

Westfield also reveals that a large share of its online business occurs outside standard shopping centre trading hours:

Analysis of Westfield's online business reveals that 48 per cent of transactions made online are made outside of standard shopping centre trading hours. There is clearly a consumer need to engage in retail outside of normal shopping and working hours. (sub. 103, p. 34)

This suggests that consumers' preferences for shopping are not being reflected in the regulated shopping hours. Shifting to online shopping may mitigate the loss of consumer welfare to some extent. However, concerns regarding consumer welfare remain as not all goods may be offered online. Also, for some consumers, the convenience and utility of immediately acquiring the good or inspecting/testing the good at a bricks and mortar retailer cannot be replicated over the internet.

Some consumers will only maximise their welfare if they can buy from a bricks and mortar store because that accords with their preferences. So irrespective of whether a good can be bought online, they prefer to buy in person at a retail store. Providing online access for them does not bring forward the same amount of consumer welfare even if they can purchase the same goods online. As a consequence, restricting retail trading hours reduces consumer welfare for this group of consumers. Put simply, these consumers value the bricks and mortar 'shopping experience' above the online experience.

### **Do retail prices increase more slowly (or fall more rapidly) following deregulation of retail trading hours?**

If deregulation of trading hours improves competition and promotes a more efficient allocation of resources in the retail industry then some of the benefits could be passed on to consumers in the form of lower prices. If so, it might be expected that average retail prices in states implementing deregulation would increase more slowly (or fall more rapidly) than prices in other, more regulated, states in the period after deregulation.

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Again, Access Economics (2003) tested this hypothesis for New South Wales, Victoria and the ACT and concluded ‘there is very weak evidence for minor reductions in retail price growth’ (p. 30).

The retailers most adversely affected by trading hours regulation are larger entities with greater scale economies that give them a cost and price competitiveness advantage over other retailers. Allowing such retailers to trade during longer hours would be expected to generate downward price pressure, relative to what otherwise would apply, across all retailers. But at the same time, longer opening hours might lead to increased variable costs (more employees and longer hours of work) which may more than offset the greater exploitation of scale economies. Retail prices following deregulation, could move up or down (or not at all) depending on the relative strengths of these opposing price effects.

The Brooker and King (1997) modelling results are more supportive of retail price reductions following deregulation in Australia. In their model an extension of shop trading hours reduces the total cost of retail goods to consumers relative to the ‘ticket’ price at the shop through a decline in the cost of shopping (box 10.7).

Consistent with the Australian evidence, the overseas theoretical and empirical literature on the price effect of retail trading hours deregulation is mixed and inconclusive. Some theoretical models predict price increases associated with higher costs while others predict price decreases arising from greater competition. Similar ambiguous outcomes arise from studies relying on empirical approaches (box 10.8).

### **Do aggregate employment hours in retail increase following deregulation of retail trading hours?**

Analysing the effect of deregulated trading hours on the aggregate hours and levels of employment is problematic. On the one hand, for those retailers allowed to trade for longer following deregulation, it would be expected that hours of employment would increase as they respond to consumer preferences to shop at more convenient times. On the other hand, for those retailers previously protected from competition by restricted trading hours, the increase in competition may result in them exiting the market, reducing employment hours.

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## **Box 10.8 Theoretical and empirical studies on the effects of liberalisation of shop opening hours**

### **Effects on retail prices**

Kay and Morris (1987) present a model under which competition in a deregulated market could induce higher retail prices driven by increases in operating costs relative to a situation of restricted shopping hours. In contrast, Clemenz (1990) shows that deregulation of opening hours may lead to lower prices in a model with consumer search: longer shopping hours facilitate more extensive search activity, which, in turn, leads to lower prices.

Tanguay et al. (1995) predicts that deregulated trading hours would shift demand from smaller, closer shops to larger ones that are further away and that this shift in demand makes it possible for large shops to increase prices. This was borne out in their empirical analysis of the deregulation of opening hours for Quebec, Canada. They find price increases were generated in large grocery stores that tended to maintain extensive opening hours. The UK empirical analysis in Kay and Morris (1987), on the other hand, suggests lower costs and lower prices following deregulation (which is also in contrast to their own modelling results mentioned above).

### **Effects on retail employment and hours of work**

Gradus (1996) estimates a model of retail behaviour for the Netherlands and simulates the employment impact of deregulating store opening hours using evidence from the Swedish experience with deregulation. Employment goes up mainly because of an increase in employed persons (rather than an increase in hours worked by existing employees). However, the magnitude of this effect depends on the average number of additional shopping hours as a consequence of deregulation.

Burda (2000) presents a model that suggests shop opening laws will in general have a negative effect on employment and output. Regulation of opening hours is likely to concentrate purchases inefficiently over shorter time intervals, leading to higher capital intensity of production, higher prices, and potentially less activity in the sector.

Burda and Weil (2005) examine the effects of restrictions on shop opening hours in the United States over the period 1969-93 using a general equilibrium model in which consumers value 'communal leisure'. They find that the regulation significantly reduces employment both inside and outside the retail sector and the employment reduction appears to come at the cost of part-time employment. That is, trading hours regulations restrict the availability of part-time jobs.

Skuterud (2005) identifies how retail employers adjusted employment levels and hours of work in those Canadian provinces where deregulation resulted in significantly more Sunday store openings. The empirical results suggest that the increase in labour demand was mainly satisfied through an increase in employed persons. The results also suggest that the employment increases were larger among general merchandise stores than among more specialised retail establishments and were relatively modest at the level of the entire retail industry.

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Access Economics (2003) tested this hypothesis for New South Wales, Victoria and the ACT and concluded that there is some evidence of increased employment in New South Wales but the evidence 'is weak at best' and the evidence for Victoria and the ACT is 'inconclusive'. Again, the modelling results of Brooker and King (1997) are more supportive of increased employment (but in their case modelled on a persons rather than hours basis) following the deregulation of retail trading hours.

Anecdotal evidence from the Bulky Goods Retailers Association suggests that the Western Australian Government's proposal to permit Sunday trading in 'whitegoods' and other 'bulky' goods is forecast to result in an increase in employment in that State:

The forecast sales in this financial year under the current trading regulation is \$8.4 billion. Allowing for a 5-10% increase in sales directly arising from the extended trading hours the revised forecast sales revenue would be approximately \$8.8-\$9.2 billion. This represents increased sales of \$400-\$800 million. The corresponding increase in employment arising from the combined effect of increased sales and one additional trading day is estimated to be approximately 1210-2420 full time equivalent jobs directly ... (sub. 109, p. 25)

Unlike the weak and inconclusive Australian evidence, the overseas economic literature is more clear cut in relation to employment. Deregulation of trading hours stimulates employment in the retail industry, in most cases due mainly to an increase in employed persons — rather than as a result of increased hours of work by existing employees (box 10.8). Further, Tanguay et al. (1995) shows that following deregulation in Quebec, the number of overtime hours worked by employees did not increase. The pattern of overtime hours remains constant following deregulation and is very similar to the pattern of overtime hours of the previous year at the same period.

The retail employment effects have been shown to be large after the liberalisation of trading hours in some countries. For example, following the abolition of regulations on opening hours in Sweden, employment rose by 1.5 per cent (Pilat 1997).

### *Effects of deregulation on retail employees*

When trading hours are extended beyond a full-time worker's 'normal' working week, it is usually the case that part-time and casual employees are used to fill at least some of the gap. Deregulation of trading hours provides those individuals who prefer to work outside of 'normal hours' with job opportunities they would not have otherwise. As Kiel and Haberkern (1994) remark:

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Different people place different values on leisure at particular times and consequently positions during extended trading hours will ultimately be filled by those who feel most advantaged/least disadvantaged by working those hours. (p. 20)

So those who fill jobs, say on Sundays and public holidays, ultimately tend to be those who feel least disadvantaged by working at these times. However, there are obviously people within the community who consider the prospect of working on a Sunday or a public holiday disagreeable:

As a former employee in the retail industry, I have personally experienced the drain [of] having to work on a Sunday or public holiday. It deprives the family of valuable bonding time, and it interferes with activities employees may otherwise engage in with their communities. (Mr Chao Qiao, sub. DR139, p. 2)

The SDA also claims that retail employees who prefer to work at evenings, nights or on weekends are in the minority:

... it is the SDA's experience that retail employees with such a view would form a minority of the retail workforce. The majority of retail employees believe there would be a significant cost to their personal, family and community time and lifestyle if full deregulation occurred. (sub. DR183, pp. 20-21)

However, it should not be assumed that the majority of people who will actually be employed, for example on Sundays or public holidays following deregulation, would necessarily feel the same way. According to ANRA, a majority of retail employees would be willing to work on any public holiday and only a small minority would not work on any public holidays:

... ANRA survey data shows 54 per cent of current and past retail sector employees would be willing to work on any public holiday and only 12 per cent of this group would not work on any public holidays. (sub. 91, p. 21)

Within that group of employees staffing shops on Sundays or public holidays, those who previously worked during the week but who prefer working on Sundays and public holidays would be obvious beneficiaries of deregulation. They would gain not only from the shift to a job more consistent with their preferences, but also because their wage rates would be higher working during these times due to the payment of penalty rates.

Even for those people who are employed in shops on Sundays and public holidays but who would prefer to work during the week, it cannot necessarily be concluded that they are worse off following deregulation. This is because the wages (including penalty rates) they receive for working on Sundays and public holidays may be high enough to compensate, or more than compensate, for the loss of wellbeing attributable to the substitution of weekday leisure for Sunday and public holiday

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leisure. Indeed, those employees who receive wages that over-compensate them are net beneficiaries of deregulation.

The only employees who are actually worse off following deregulation are those employees who work on Sundays and public holidays who regard themselves as under-compensated (despite penalty rates) for the loss of high-value Sunday and public holiday leisure time. As the SDA comments in relation to employees working on Sundays:

If you take Sundays, there's no doubt that there are many people who are happy to work on Sundays. That is also our experience. We have no difficulty with that. Where we have a problem is where you have people who for sporting reasons, family reasons or perhaps religious reasons say, 'We don't want to work on a Sunday,' and the retailer tries to require them to work. That's where we have the problem. (trans., pp. 25-26)

It is unlikely that this group of employees would be large following deregulation, because those with a strong aversion for Sunday and public holiday work would find weekday jobs, either in retailing or elsewhere, particularly when labour market conditions are tight. However, this will entail some adjustment costs for those employees who seek new jobs following deregulation. As Hogbin (1983) outlines:

In most cases the process of searching for a new job is far from pleasant, is time-consuming, and in many cases involves loss of income. Experience gained in retailing may not be valued as highly in other industries, so that those whose best alternative is to leave the industry may have to accept jobs with lower wage rates. (p. 64)

According to the SDA, that subset of retail employees who remain in the industry following deregulation, even though they regard themselves as under-compensated for the loss of high value Sunday and public holiday leisure time, will not be able to 'refuse any hours of work during the span of ordinary hours' (sub. DR183, p. 20) which includes Sundays — unless they want to risk losing their employment. But they will have the right to refuse work on public holidays.

Retail employees have the 'right to refuse work' on public holidays by virtue of section 114 of the *Fair Work Act 2009*. Section 114 prevents an employer unreasonably requesting an employee to work on a public holiday. If an employer requests an employee to work on a public holiday, the employee may refuse the request if:

- the request is not reasonable
- or the refusal is reasonable.

Sub-section 114(4) sets out the factors that must be taken into account when determining reasonableness of employer requests or employee refusals to work on public holidays (box 10.9). In addition, as Business SA suggests:

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... there is capacity to make enterprise agreements, particularly with major stores or retail chains, to ensure that no staff member will be forced to work on public holidays [irrespective of reasonableness]. (sub. DR174, p. 3)

### **Box 10.9 Determining reasonableness of employer requests or employee refusals to work on public holidays**

In determining whether a request, or a refusal of a request, to work on a public holiday is reasonable, the following must be taken into account:

- the nature of the employer's workplace or enterprise (including its operational requirements), and the nature of the work performed by the employee
- the employee's personal circumstances, including family responsibilities
- whether the employee could reasonably expect that the employer might request work on the public holiday
- whether the employee is entitled to receive overtime payments, penalty rates or other compensation for, or a level of remuneration that reflects an expectation of, work on the public holiday
- the type of employment of the employee (for example, whether full-time, part-time, casual or shiftwork)
- the amount of notice in advance of the public holiday given by the employer when making the request
- in relation to the refusal of a request — the amount of notice in advance of a public holiday given by the employee when refusing the request
- any other relevant matter.

*Source: Fair Work Act 2009.*

## **Redistributive and welfare effects**

Restrictive trading hours distort consumer shopping choices and reduce the flexibility of retailers to compete in the market place. Liberalising trading hours could, therefore, be expected to change the pattern and structure of retailing.

Morrison and Newman (1983) find that smaller, inefficient retailers have the most to gain from restricted trading hours. They present a model where the cost of shopping has two components — the ticket price of the good and the time spent by consumers to access the good. This time component includes travel time, time spent acquiring information about price and quality attributes of the prospective purchase, and the time required to effect the purchase.

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In their model, smaller neighbourhood stores have higher ticket prices but lower access costs, while larger more centrally located stores have lower ticket prices but higher access costs. Aware of the price differences across stores, consumers select stores so as to minimise the full cost (including access cost) of the goods purchased on the shopping trip. When large amounts of groceries are purchased (such as the ‘weekly shop’) they tend to be purchased at larger lower priced supermarkets, whereas, when a small number of items are purchased, consumers tend to frequent smaller, higher priced convenience stores. The concept of batch size is central to their analysis and results in the frequently observed behaviour in which a given consumer shops at both high-price and low-price stores.

Removing restrictions on opening hours has the effect of lowering access costs or lowering the opportunity cost of shopping time by allowing consumers to shop at times convenient to them. Morrison and Newman (1983) argue that the volume of sales will increase at large stores and decrease at small stores, where opening hours are extended. They provide some empirical evidence on market shares of chain and non-chain retailers in Vancouver, Canada to support their argument.

More generally, in their review of the OECD trend towards liberalising opening hours, Boylaud and Nicoletti (2001) found strong welfare gains due to:

- lowering of product and labour market rents related to the entry of new competitors and a decrease in bargaining power of retail workers, due to the rise in part-time employment
- cost efficiency improvements in larger retailers arising from increased economies of scale partly offset by an increase in costs for smaller retailers which are more susceptible to a threshold labour constraint
- an enlargement of the retail product mix.

#### *Effects of deregulation on some (generally smaller) retailers*

Expectations of losing market share from changes in the distribution of retail trade are not the only reason for opposition amongst some — generally smaller — retailers to the extension of trading hours. Those retailers that prefer not to open on Sundays and public holidays would also be worse off. In those jurisdictions where deregulation has occurred, for many small retail shops it is often the owners and their families who end up working on Sundays and public holidays — partly as a consequence of high penalty rates.

Like many others in the community, some retailers may place a high value on leisure at these times. As Dr Joellen Riley points out, during her review of the

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*Banks and Bank Holidays Act 1912* (NSW) in 2009, some small retailers indicated a preference for not opening on public holidays :

My conversations with small owner-operated retailers during the public holidays review suggested that these small business people also valued some guaranteed close-down time on these special public holidays ... (sub. DR154, p. 3)

Hogbin (1983) suggests the options available to those retailers who prefer not to open on Sundays and public holidays in a deregulated environment are unlikely to be attractive to them, these include:

- cease trade while other retailers remain open — choosing this option would almost guarantee losing trade
- hire a manager/staff to work on Sundays and public holidays — this option may not be financially viable (due to high penalty rates), the quality of service provided by the business may suffer and the business could incur losses from less efficient management
- sell the business and move into another occupation — this option would entail transitional costs and it is not clear that the skills gained in retail by the former owner would be as useful in other occupations.

If the retailer assessed the costs of pursuing any of these options as too high, they would choose to keep the retail premise open on Sundays and public holidays, but as discussed earlier, this too would be costly because it would require a sacrifice of high-value leisure time. The retailer could maintain total leisure time by closing the shop at times when sales turnover was low, for example a few days early in the week, but the sacrifice of high-value weekend leisure time for lower-valued weekday leisure time would still result in the retailer being worse off. This reinforces the significance of the value of leisure time when considering the deregulation of shopping hours:

On the one hand consumers would gain from weekend trading because the time-costs of shopping would be reduced but on the other, some retailers [but not all] will lose because the hours they work would be more costly in terms of the value of leisure time sacrificed. (Hogbin 1983, p. 49)

It is possible to undertake a ‘natural experiment’ of the overall impact on small retail businesses arising from the liberalisation of trading hours in Australia because of the differing shopping hours regimes. In Australia, there appears to be no relationship between the proportion of small retail businesses and the stringency of trading hours regulation in each state and territory using ABS information from 2008-09.

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Box 10.10 shows that the ratio of small retail businesses to total retail businesses is very similar for those jurisdictions that are ‘partially deregulated’ (Vic and Tas), those that are ‘lightly regulated’ (NSW) and those that are ‘regulated’ (Qld, WA and SA). While the results show that the proportions of small retail businesses are lowest in the most deregulated jurisdictions (ACT and NT), this may be caused by other factors unique to these territories (such as high public servant or indigenous populations), affecting their small business counts.

**Box 10.10 Small retail businesses as a proportion of the retail industry**

- Deregulated — ACT (87.6%) and Northern Territory (85.1%)
- Partially deregulated — Victoria (92.7%) and Tasmania (93.0%)
- Lightly regulated — New South Wales (93.4%)
- Regulated — Queensland (91.1%), Western Australia (89.6%) and South Australia (92.2%).

Small retail businesses are defined as those businesses that employ less than twenty people or are non-employing.

*Source: ABS (Counts of Australian Businesses, year ending 2008-09, Cat. no. 8155.0).*

Consistently high small business participation rates of around 90 per cent in both regulated and deregulated states and territories suggests that trading hours have little influence over the level of market participation by small retail businesses. In Australia, deregulation of trading hours does not appear to have had a deleterious effect on the viability of small retail businesses.

The ABS data from 2008-09 on business counts supports previous research undertaken by Kiel and Haberken (1994). They examined the hypothesis that increased trading hours will reduce the number of small businesses by comparing the number of retail establishments in ABS retail censuses and changes to trading hours using a statistical analysis. Their analysis found that there was no obvious or immediate connection between shop opening hours and the number of retail establishments or that the number of shops increased or decreased at the same time as trading hours increased. They also tested for possible delay between trading hours change and the number of retail shops, and no significant relationship was found. Kiel and Haberken concluded that the hypothesis that the number of retailers falls at the same time as, or some time after, an extension in trading hours is not substantiated by the data.

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These empirical results do not imply that states and territories that liberalised trading hours did not cause some adjustments in the structure of ownership (and the workforce) in the retail industry. This is because, following liberalisation, there was likely to have been some transfer of ownership of retail businesses (and movement of labour as discussed in the previous section). For example, the businesses of those small retailers who left the industry (rather than trade in a newly liberalised environment) were likely to have been taken over by people either already in the industry or by people from outside the industry who were prepared to open under a less regulated or deregulated trading hours regime.

However, any move to full deregulation by all states in the near future would be unlikely to cause as much structural adjustment as that which occurred following previous liberalisation efforts. This is because most of the adjustment (and associated costs) has already occurred following the significant reforms to trading hours made by most states between 1996 and 2003. In other words, the biggest steps on the path to full deregulation have already been taken.

## **10.5 Should retail trading hours be fully deregulated?**

Retail trading hours regulation prevents some retailers from trading during specified hours or on specified days or in specified locations. Such regulation reduces retail competition because only specified retailers are affected, discriminating in favour of non-regulated retailers, including online retailers.

As consumers have become increasingly time poor, convenience in terms of when they can shop and where they can shop is becoming more highly valued. Consumers not only want to minimise the financial costs of their purchases, but also the time involved with searching and purchasing. Consumers express a preference for shopping at stores that are convenient, in terms of location and opening hours and opening days. Retail trading hours regulation reduces consumer choice about where and when to shop and what can be purchased. Shifting to online shopping may mitigate the loss of consumer welfare to some extent. However, forcing shoppers online because of trading hours restrictions does not maximise consumer welfare.

There are substantial consumer welfare benefits from retail trading hours deregulation in terms of greater convenience and product choice. Most consumer surveys show a strong consumer preference for deregulated trading hours prior to liberalisation of trading hours. The subsequent change in shopping behaviour confirms those preferences: following liberalisation there is a strong shift by consumers towards the deregulated hours. For example, in those states and territories where Sunday trading has been introduced, it has been found to quickly

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become one of the most important trading days. For the vast majority of retailers deregulating shop trading hours is not about operating 24 hours a day seven days a week but simply being able to open to meet the needs of consumers, at times when retailers can also trade profitably.

There is also domestic and overseas empirical evidence of some benefits to the overall retail industry from the removal of artificial distortions driving expenditure into non-retail areas. The effect on retail sales from deregulating trading hours is generally found to be positive. Extending retail trading hours does not simply mean that the same amount of money is being spent, but over a longer period.

Benefits to consumers may also arise from increased competition, driving greater efficiency in the use of resources in the retail industry, and lowering average prices relative to what would have occurred otherwise — although the domestic and international empirical evidence is somewhat mixed and inconclusive.

Finally, the deregulation of trading hours overseas has been found to stimulate employment in the retail industry — although the domestic evidence is less clear cut — in most cases due mainly to an increase in the number of employed persons rather than increased hours worked by existing employees. Deregulation of trading hours will provide those individuals who prefer to work outside of ‘normal hours’ with job opportunities they would not have otherwise — since there will be more jobs tailored to their preferences. For many other individuals, the higher wage rates will compensate them for the net loss of value of leisure time, so they will also benefit from such a change.

In summary, from a community-wide perspective there are good reasons why retail trading hours in Australia should be fully deregulated:

- increased consumer welfare benefits associated with greater convenience and product choice
- reduced discrimination between retailers
- a less artificially distorted retail industry
- potentially lower retail prices and higher retail employment.

While some retail businesses and employees may suffer some once-off adjustment costs following deregulation, these costs are likely to be relatively small given most states and territories have already made significant progress towards the deregulation of trading hours. The adjustment costs are also likely to be smaller than the benefits to the community following deregulation (listed above), particularly the greater convenience for consumers able to shop at times and locations better suited to their requirements.

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It is now nearly 25 years since ER Kelly inquired into the efficacy of retail trading hours legislation in Western Australia and concluded:

... it appeared clear to me that such a law could only be justified if it demonstrably saved the community from some serious and clearly perceived harm, or conferred on it some almost universally approved benefit.

At the end of the Inquiry I am satisfied that the present law in Western Australia serves neither of those purposes ... It gives an advantage to some retailers over others; ... and to retailers in some areas of the State over retailers in other areas. It protects some retailers from competition from other retailers. It creates obstacles to competition in an area in which the community is best served by competition. It makes judgements about what the community wants in a sphere of activity in which the community itself should be left to demonstrate by its patronage what it wants. (Kelly 1986, p. 120)

Whilst there has been some piecemeal liberalisation of trading hours in Western Australia, and more substantial regulatory reforms in some other states and territories since 1986, the conclusion the Commission draws today is essentially the same as ER Kelly: retail trading hours legislation should be repealed. There is no role for governments in determining retail trading hours.

Retailers should have the freedom to open their shops whenever they want to trade. In today's more competitive, globalised retail trading environment, where consumers have greater access to goods from all over the world through online suppliers, there is now an even stronger imperative for retailers to not be inhibited in their ability to respond to changing consumer tastes and preferences.

A number of submissions have suggested that the Victorian (or Tasmanian) model should be followed by those remaining states with trading hours regulation (SCCA, sub. 67; Coles, sub. 79; Myer, sub. 88; ANRA, sub. 91). That is, regulating non-trading periods for Christmas Day, Good Friday and the morning of Anzac Day only (unless an exemption has been granted to trade on these days). Given the experience of the ACT and the Northern Territory with fully deregulated trading hours — where the above days are generally observed by tradition or convention as closed days — any regulation would appear unnecessary and unwarranted.

RECOMMENDATION 10.1

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

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# 11 Workplace relations regulation

## Key points

- Workplace practices have an important role to play in ensuring the operational flexibility of retailers and increasing the productivity of the retail industry.
- Some retail employers and industry groups raised concerns about the impacts of workplace relations legislation and awards on wage outcomes, workplace flexibility, productivity and employment. At the same time, many retail employees and unions highlighted the relatively low levels of pay in the industry. Unions also argue that the current workplace relations system provides sufficient flexibility.
- A particular concern of employers relates to increases in penalty rates as a result of award modernisation and the consequent impact on retailers' ability to trade profitably at times many consumers now prefer to shop. High minimum award wages are also said to be constraining the ability of employers to restructure employee remuneration in ways that could enhance productivity, for example, through greater use of performance-related commission or incentive payments. The award requirement that casuals be engaged for no less than three hours has also constrained workplace flexibility.
- The industry remains relatively award reliant and many employers and their employees appear not to have adequately taken advantage of opportunities to examine how workplace practices might be improved. It is critical that employers, employees and unions work constructively to implement productivity enhancing workplace arrangements, including those focused on operational and trading hours flexibility and improved customer service.
- Participants have argued that provisions under the Fair Work Act, in particular the 'every worker must be better off overall' test, are increasing the cost and complexity of negotiating enterprise agreements and making productivity improvements more difficult to achieve.
- The Australian Government should examine these and other concerns about the operation of the Fair Work Act. The signalled post-implementation review of the Act, to commence before 1 January 2012, should provide the appropriate review mechanism.
- Concerns about retail awards should also be considered by Fair Work Australia in the scheduled review of modern awards in 2012.

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## 11.1 Introduction

The retail industry is highly labour intensive with over 70 per cent of the value added created by the industry accruing to workers (ABS 2010j). Accordingly, the way in which workers are employed, their productivity and the flexibility of workplace practices are of great importance for the future of the industry, its competitiveness and its contribution to the economy and broader community.

The terms of reference for this inquiry ask the Commission to examine any regulatory or policy issues that impact on structural change in the industry. This chapter examines workplace relations regulations and related policy issues.

As discussed in chapter 3, the Australian retail industry's future performance will depend on its ability to respond effectively to changing consumer demand and to increasing competitive pressure from international retailers, including online competition. The system of workplace relations regulation — together with how effectively employers respond to the opportunities to improve workplace practices that exist within the system — has an important role to play in ensuring the retail industry has the operational flexibility that will be needed.

Wages are, for many retail businesses, growing at a faster rate than the prices of the goods they sell, especially in light of price deflation in some categories of those goods. As can be seen from figure 11.1, growth in average weekly earnings, which incorporates both the effects of changes in wage rates as well as changes in the composition of the workforce, has for the retail industry consistently exceeded growth in retail prices.

Labour costs account for a higher percentage of sales revenue in the Australian retail industry than in comparable parts of the retail industry in some other developed countries, such as the United States and the United Kingdom (section 11.4). Part of the explanation for the lower total labour costs to sales ratio overseas appears to be higher labour productivity, which in turn is influenced by capital investments and the adoption of workplace flexibility initiatives, amongst other factors.

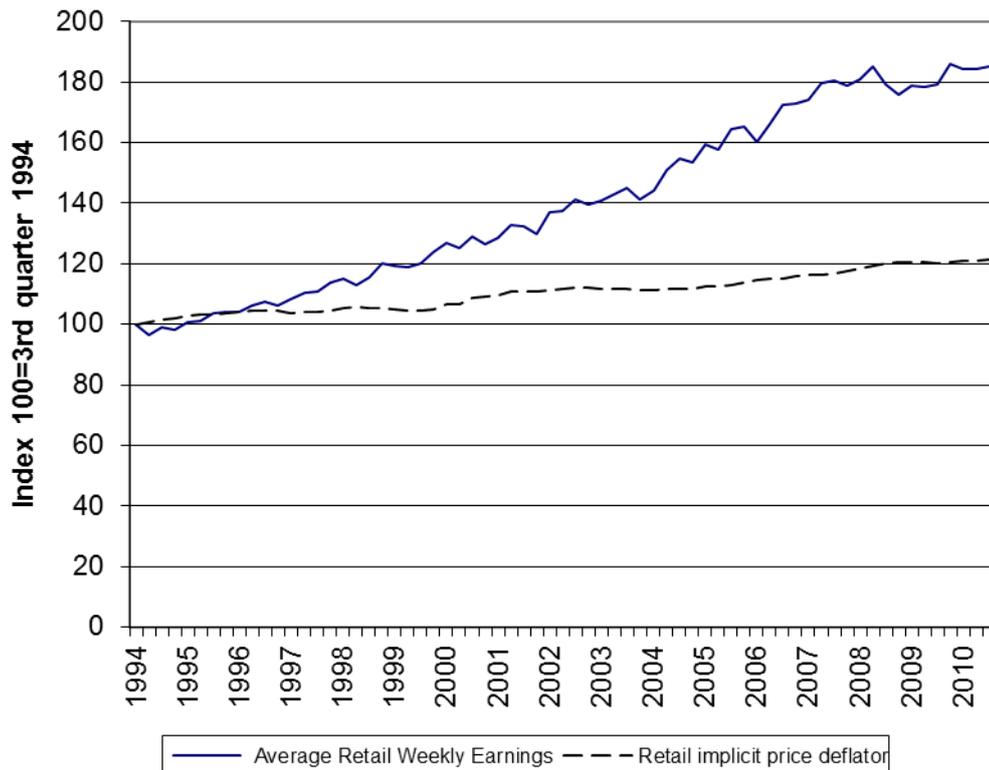
Notwithstanding the slower growth in retail prices, it would appear that higher labour costs in Australia have largely been passed onto consumers. This is consistent with evidence that labour costs as a percentage of sales revenue and rates of profit have remained fairly stable over recent years.

With the advent of greater global online competition Australian retailers will be under increasing pressure to control cost increases. It is particularly important that labour productivity growth in retail enterprises is, at a minimum, strong enough to

offset the growth in wage costs. As explained in chapter 3, even greater improvements will be needed to help narrow the existing productivity gap between Australia and countries such as the United States.

**Figure 11.1 Growth in average weekly earnings and implicit price deflator for retail**

3rd quarter 1994 = 100



Data sources: ABS (Average Weekly Earnings Cat. no. 6302.0; Retail Trade Australia Table 5 Cat. no. 8501.0).

Attaining greater flexibility in retail workplaces needs to play an important role in delivering the necessary productivity growth. Employers, employees and unions clearly have a common interest in ensuring the long-term prosperity of the Australian retail industry. There needs to be a shared commitment from all parties to working cooperatively to deliver the required productivity improvements. With creative thinking and the adoption of innovative measures, strong productivity growth can be achieved and provide the basis for improvements in the overall pay and conditions and job satisfaction of retail employees. The Commission recognises that a sharing of the benefits that derive from greater workplace flexibility is likely to deliver the best outcomes for all parties, including retail consumers.

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Furthermore, beyond workplace arrangements, there are many other aspects of retail operations and business practices that provide scope for productivity enhancing changes. Some of these are discussed later in this chapter and/or in some cases are covered in other chapters.

The rest of the chapter is organised as follows:

- industrial relations laws and institutional arrangements (section 11.2) — a brief discussion of the evolution and key elements of the new workplace relations system
- setting pay and conditions in retail (section 11.3) — including an overview of minimum award wage setting and enterprise agreement making
- wages and earnings outcomes (section 11.4) — a summary of key statistical data on outcomes and trends in the retail industry
- concerns about awards and labour costs (section 11.5)
- workplace flexibility (section 11.6) — discusses the importance of flexibility, evidence regarding the adoption of flexible practices in Australian retail, barriers to achieving flexibility and the scope for further innovation.
- conclusions and recommendations (section 11.7).

Since the draft report, this chapter has benefited from substantial further input from participants, including the views and evidence presented by unions and workers employed in the retail industry.

## **11.2 Industrial relations laws and institutional arrangements**

Australia's industrial relations laws and institutional arrangements have undergone major changes over the last 25 years. Historically, Australia had a highly centralised and formalised industrial relations system. The Australian Industrial Relations Commission (AIRC) made national wage case determinations that were subsequently reflected in variations to awards which regulated basic wages and working conditions. There were a very large number of state and federal awards covering a wide range of occupations and organisation types within an industry.

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In the late 1980s, a process began of significant award restructuring and simplification,<sup>1</sup> and a shift from centralised wage fixing to enterprise bargaining. Reform accelerated in the mid 1990s with the introduction of the *Workplace Relations Act 1996*, further award simplification (and a focus on a basic ‘safety net’ of conditions) and the introduction of individual employment contracts (Australian Workplace Agreements). The overall effect was to substantially reduce the role of tribunals in determining wages and conditions and to encourage direct bargaining (constrained by only limited core requirements) at the enterprise level, including the negotiation of individual agreements.

Across Australia, the proportion of employees having wages set by collective enterprise agreements or individual agreements steadily increased from 32 per cent in 1990 to almost 80 per cent in 2002 (PC 2005). This proportion stood at approximately 75 per cent in May 2010 (ABS 2010d).

The shift from the traditional highly prescriptive, centralised system of awards towards a more decentralised system of industrial relations, reflected a growing recognition that rigidity in the system had been inhibiting flexibility and adaptability within firms. Governments identified the scope for productivity and efficiency gains from a system that was better able to take into account the particular circumstances of individual workplaces and their employees.

## **Fair Work System**

Further substantial changes to the workplace relations system have been made more recently. The new Fair Work system commenced operation on 1 July 2009 and took full effect from 1 January 2010. Its coverage extends to all private sector employers and employees in Australia, except unincorporated enterprises (e.g. sole traders and partnerships) in Western Australia, which has not referred its industrial relations powers to the Federal Government.<sup>2</sup>

The new system provides a stronger safety net for employees than under the previous *Work Choices* system, with a wider range of enforceable minimum protections. The following are some of the key elements of the new system.

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<sup>1</sup> Award simplification involves changes that are intended to make award provisions easier to understand and administer, while maintaining their original intent. Award restructuring, on the other hand, is broader in scope and can cover changes to the intent of award provisions.

<sup>2</sup> The previous Federal Government implemented a national workplace relations system which relied on the Corporations Power under the Australian Constitution, and the current Government used that platform to implement the Fair Work system. In Western Australia, the Fair Work system does cover employees in constitutional corporations.

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- The *Fair Work Act 2009* (FW Act) and the associated Fair Work Regulations 2009, which together provide the legislative framework and rules.
  - Fair Work Australia (FWA) — the national workplace relations tribunal established to oversee Fair Work with the power to vary awards, make minimum wage orders, approve agreements, determine unfair dismissal claims and make orders on various matters to help employees and employers resolve disputes.<sup>3</sup>
  - Fair Work Ombudsman (FWO) — provides an information and advice service on all aspects of workplace relations. Inspectors, with strong investigative powers, work under the Ombudsman to assist employers, employees and organisations to comply with workplace relations laws and, where necessary, take steps to enforce the laws through the court system.
  - National Employment Standards (NES) comprising 10 legislated essential employment conditions (box 11.1).
  - Modern Awards — industry or occupation-based awards that rationalised and streamlined thousands of state and federal awards and set out minimum wages and employment conditions for those employees covered.
  - Enterprise Agreements — these remain a feature of the new system and employers and employees are able to bargain over a wide range of matters, but there have been significant revisions to the provisions governing the making and approval of such agreements, including in relation to the role of unions and the application of a ‘better off overall test’. The Fair Work System also enables multi-enterprise agreements (multiple employers may choose to bargain together, without having to satisfy a public interest test).
  - A separate multi-employer bargaining stream for the low paid — this stream is intended to help workers who have not had access to collective bargaining in the past. FWA will facilitate the making of agreements and must determine if the proposed bargaining is in the public interest (decisions are subject to appeal) and individual employers can seek exemption from the process.
  - Unfair dismissal laws — revised laws provide employees, particularly those in small businesses previously exempt from the laws, with greater protection from unfair dismissal.
  - Individual flexibility arrangements — every modern award and enterprise agreement must include a ‘flexibility term’ which allows an employer and an individual employee to negotiate arrangements to meet their individual needs;

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<sup>3</sup> Fair Work Australia replaced the following Australian Government agencies: Australian Industrial Relations Commission; Australian Fair Pay Commission (and Secretariat); Australian Industrial Registry; and the Workplace Authority.

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providing the employee is better off overall under the arrangements. The extent to which this has facilitated genuine flexibility is discussed in section 11.6.

### **Box 11.1 National Employment Standards**

The National Employment Standards (NES) comprise 10 legislated essential employment conditions covering:

- maximum weekly hours of work
- the right to request flexible working arrangements
- parental leave and related entitlements
- annual leave
- personal/carer's leave and compassionate leave
- community service leave
- long service leave
- public holidays
- notice of termination and redundancy pay
- provision of a Fair Work Information Statement, which details the rights and entitlements of employees under the new system and how to seek advice and assistance.

The NES, contained in the *Fair Work Act 2009* (ss. 59-131 of Chapter 2, part 2-2), are minimum standards applying to the employment of employees which cannot be displaced, even if an enterprise agreement includes terms that have the same (or substantially the same) effect as provisions of the NES.

*Source:* DEEWR (2010b).

The Australian Government committed to undertaking a post-implementation review of the Fair Work Act, within two years of its full implementation, that is by 1 January 2012. This was a consequence of the (then) Prime Minister granting an exceptional circumstances regulation impact statement exemption at the decision-making stage.

While the Government has given an indication that the review of the Fair Work Act will be an independent review, in that it will not be conducted by the policy Department, (Vasek 2011), very little information has been publicly released on the scope and nature of the review.

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## 11.3 Setting pay and conditions in retail

Awards are legally enforceable documents that specify the conditions and obligations in an employment relationship. They set out minimum wages, penalty rates, loadings and other conditions. They provide employees ‘with a degree of certainty in their employment’ (Unions WA, sub. DR185, p. 6) but also specify certain obligations of employees such as the requirement to give notice of resignation.

Retail employees are more likely than workers across all industries to receive wages set by an industrial award, and less likely to have their wages set by collective agreement or individual arrangement, although award reliance has been declining, consistent with a broader trend in the economy.

In May 2010, 22 per cent of *all employees* in the retail trade industry had their pay set by awards, well above the corresponding proportion for all industries (15 per cent); 41 per cent had their pay set by a collective agreement (compared with 43 per cent for all industries); and 33 per cent had their pay set by individual arrangement (compared with 37 per cent across all industries) (ABS 2010d).

The level of award reliance of employees in retail has fallen substantially since 2000 (table 11.1). Retail trade was the second or third most award-reliant industry in the years 2000 to 2008, but was the fifth most award-reliant industry in 2010.

**Table 11.1 Proportion of all employees reliant on awards: retail and all industries, May 2000 to May 2010<sup>a</sup>**

	2000	2002	2004	2006	2008	2010
	%	%	%	%	%	%
Retail trade	34.9	34.2	31.3	28.7	28.9	22.3
All industries	23.2	20.5	20.0	19.0	16.5	15.2

<sup>a</sup> Figures are for May each year, except for 2008, which are for August. Prior to 2008, data were classified according to the Australian and New Zealand Standard Industrial Classification (ANZSIC), 1993 edition. The data for 2008 and 2010 are based on the ANZSIC 2006 edition. Equivalent figures for 2008, based on the ANZSIC 1993 edition, were: Retail Trade 29.3 per cent and All industries 16.3 per cent.

Source: ABS (*Employee Earnings and Hours*, various, Cat. no. 6306.0).

The proportion of *non-managerial employees* that have their pay set by awards is higher than the proportion for all employees, because of the higher incidence of individual arrangements for management employees. For example, based on unpublished data from the ABS Employee Earnings and Hours Survey for May 2010 provided to the Commission by the Department of Education, Employment and Workplace Relations (DEEWR pers. comm., 16 June 2011), 23.3 per cent of

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non-managerial retail trade employees and 16.4 per cent of non-managerial employees across all industries had their pay set by awards.

### **Setting of minimum wages**

Under the Fair Work System, minimum wages are set and adjusted by a specialist Minimum Wage Panel within FWA. FWA undertakes annual reviews, with updated wage rates in modern awards, enforceable by law, taking effect from 1 July each year.<sup>4</sup> The Minimum Wage Panel also makes national minimum wage orders for employees who are not covered by a modern award. The Panel may take various matters into account in determining minimum wages (box 11.2).

#### **Box 11.2 Determination of minimum wages**

When setting and adjusting minimum wages, the Minimum Wage Panel may take the following into account:

- the performance and competitiveness of the national economy, including productivity, business competitiveness and viability, inflation and employment growth
- promoting social inclusion through increased workforce participation
- relative living standards and the needs of the low paid
- the principle of equal remuneration for work of equal or comparable value and
- providing a comprehensive range of fair minimum wages for junior employees, employees to whom training arrangements apply and employees with a disability.

In reviewing modern award minimum wages, FWA must take into account various additional matters, including (but not limited to):

- the need to encourage collective bargaining
- the need to promote flexible modern work practices and the efficient productive performance of work
- the likely impact of any exercise of modern award powers on business, including on productivity, employment costs and the regulatory burden.

*Source:* DEEWR (2010b).

Minimum wage decisions flow through modern awards via a tiered structure of wage classification levels (for example, eight levels in the General Retail Industry

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<sup>4</sup> FWA may, in limited circumstances, also vary award wages outside of these reviews.

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Award), covering low paid unskilled workers through to managerial employees at higher levels of pay.

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

Minimum wage decisions can also affect other wages indirectly by acting as a floor for wage increases achieved through workplace bargaining. According to the DEEWR Workplace Agreements Database, ‘around 37 per cent of current federal enterprise collective agreements (CAs) covering 24 per cent of all employees under federal enterprise agreements are linked in some way to annual wage review outcomes’ (Australian Government 2011b, p. 4). More generally, even where there is no direct or explicit link, higher minimum wage increases are likely to place a floor under wage claims and outcomes in workplace bargaining negotiations. This is particularly likely to be the case given the requirement that all employees are made ‘better off overall’ by any agreement.

## **Review and rationalisation of awards**

In 2008, the AIRC commenced a process of reviewing and rationalising thousands of state and federal awards, with the objective of creating a system of streamlined and simplified ‘modern awards’ as part of the new national Fair Work System.

The first 122 modern awards commenced on 1 January 2010 — including the General Retail Industry Award 2010 — coinciding with the introduction of the new national workplace relations system. For the purposes of the Award, ‘general retail industry’ means the sale or hire of goods or services to final consumers for personal or household consumption. Further information on the coverage of the General Retail Award is provided in box 11.3.

Other specific modern awards applicable to the broader retail industry include:

- Pharmacy Industry Award 2010
- Meat Industry Award 2010
- Nursery Award 2010
- Vehicle Manufacturing, Repair, Services and Retail Award 2010.

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### **Box 11.3 Coverage of the General Retail Industry Award**

For the purposes of the Award, general retail industry includes:

- food retailing, supermarkets, grocery stores
- department stores, clothing and soft goods retailing
- furniture, houseware and appliance retailing
- recreational goods retailing
- personal and household goods retailing
- household equipment repair services
- bakery shops
- customer information or assistance provided by shopping centres/retail complexes
- labour hire employees engaged to perform work otherwise covered by this award
- newspaper delivery drivers employed by a newsagent.

But does not include:

- community pharmacies
- pharmacies in hospitals and institutions providing an in-patient service
- hair and beauty establishments
- hair and beauty work undertaken in the theatrical, amusement and entertainment industries
- stand-alone butcher shops
- stand-alone nurseries
- retail activities conducted from a manufacturing or processing establishment other than seafood processing establishment
- clerical functions performed away from the retail establishment
- warehousing and distribution
- motor vehicle retailing and motor vehicle fuel and parts retailing
- fast food operations
- restaurants, cafes, hotels and motels
- building, construction, installation, repair and maintenance contractors engaged to perform work at a retail establishment.

*Source:* General Retail Industry Award (2010).

Modern awards build on the National Employment Standards (NES, box 11.1) and may include an additional 10 minimum conditions of employment. These include: minimum wages; types of employment; arrangements for when work is performed;

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overtime and penalty rates; annualised wage or salary arrangements; allowances; leave related matters; superannuation; and procedures for consultation, representation and dispute settlement. Every modern award must also include a flexibility clause which has the aim of enabling employers and employees to negotiate arrangements to meet their individual needs, provided the employee is better off overall under the arrangements (see discussion of individual flexibility arrangements in section 11.6).

### *Award modernisation process*

The award modernisation process was conducted in accordance with the (then) Minister's written award modernisation request. This required, amongst other things, that the AIRC take a consultative approach to award modernisation. The AIRC, over a two year period, issued exposure drafts of modern awards for comment, accepted written submissions and conducted public consultations to allow stakeholders to comment on matters of concern.

The award modernisation process was a challenging task. The AIRC was required to set new national benchmarks with pre-modern awards containing a diverse range of conditions. The process reduced 3715 state and federal instruments, many of which were complex and lengthy, to 122 modern awards. In selecting appropriate wage levels and other conditions in modern awards, the AIRC's approach was to select new benchmarks based on the most prevalent conditions existing in the range of pre-modern awards.

The AIRC made the General Retail Industry Award 2010 (Retail Award) on 19 December 2008 as part of the priority stage of award modernisation. During the award modernisation process a number of representations were made by industry stakeholders regarding penalty rates and hours of work provisions in the Retail Award. Employers were concerned that increases in the casual loading and changes to the penalty rate structure would increase costs for the industry. There were particular concerns about Sunday penalty rates for casual employees.

The Department of Education, Employment and Workplace Relations (DEEWR) examined the retail industry's concerns and on 26 August 2009 the Minister varied her award modernisation request, asking the AIRC to ensure that the hours of work and associated overtime penalty arrangements in the retail, pharmacy and any similar industries do not operate to discourage employers from offering additional hours of work to part-time employees and employing part-time permanent employees rather than casual employees. Prior to commencement of the Award, it was varied in response to a number of applications (section 11.5).

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Notwithstanding the complexity and scale of the modernisation task, it was at the same time limited in terms of the scope of changes that were under consideration. Indeed, the Australian Chamber of Commerce and Industry (ACCI) viewed the process as ‘highly constrained’ for all participants involved:

The process did not involve a detailed consideration of the merits of whether historical employment standards (which are artefacts of a bygone era of ‘paper’ disputes initiated by trade unions in the most part) should be retained or modified to better suit the contemporary world of work. Whilst ACCI supports a sustainable and effective safety net of minimum wages and conditions, in many ways the so-called ‘modern awards’ preserve existing award terms. (sub. DR196, p. 11)

### *Review of modern awards*

Under the FW Act, FWA is required to undertake four yearly reviews of each modern award, but as a transitional measure interim reviews of modern awards, including the General Retail Industry Award, are to be undertaken in 2012. The interim reviews by FWA must include consideration of whether the award is achieving the modern awards’ objective and whether awards ‘are operating effectively, without anomalies or technical problems arising from the modernisation process’. FWA ‘may make a determination varying any of the modern awards in any way that FWA considers appropriate to remedy any issues identified in the review’ (Item 6, Schedule 5 of the *Fair Work (Transitional Provisions and Consequential Amendments) Act 2009*).

Some in industry have raised concerns about the magnitude of the task, the challenges it will present and the capacity for a meaningful review of each modern award. The ARA submission stated:

FWA is obliged to review all modern awards as part of this process. With over 120 modern awards to be reviewed there is a well-founded fear in the business community that there will be insufficient time for the review to fully evaluate each individual award. This is coupled with a complete absence of information from FWA about how they will be undertaking the process. (sub. DR162, p. 7)

FWA should release further details about the modern award review process as soon as possible and ensure that sufficient time and resources are made available to allow an appropriate examination of each award, with opportunities for all stakeholders to provide input.

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## Enterprise bargaining

Employment arrangements negotiated between employers and employees at the enterprise level can reflect the unique characteristics and circumstances of individual workplaces more closely than industry-wide awards.

The Australian Government continues to promote the benefits of enterprise bargaining:

The Government has long held the view that enterprise bargaining is important in boosting productivity and has delivered economic benefits to both employers and employees over the past decade and a half. This is why enterprise bargaining is at the centre of the FW Act. (Australian Government 2010, p. 94)

The negotiation of a comprehensive (collective) enterprise agreement is one mechanism for tailoring work practices to meet the needs of individual firms and their employees. In the past, management could also achieve this outcome through individual contracts with some or all employees. Indeed, as noted earlier, in May 2010, one third of employees in the retail industry had their pay set by individual arrangement. Statutory individual agreements are not permitted under the new Fair Work System, although, as noted above, every agreement must contain a flexibility clause. The scope provided by these provisions, in practice, to facilitate genuine workplace flexibility is still being tested, but has been subject to some negative comment (see section 11.6).

According to the DEEWR Workplace Agreements Database, there were just over 2000 retail enterprise agreements *current* at 31 December 2010, covering just under 400 000 employees. Enterprise agreements are far more common in larger establishments and nearly all (over 90 per cent) of retail agreements fall into either the Food Retailing or the Other Store-Based Retailing subdivisions. Although within the latter subdivision, the Commission notes the advice of the Pharmacy Guild of Australia that ‘pharmacy employers have not converted to agreement making (in any form) in numbers of any significance’ (sub. DR181, p. 4).

Table 11.2 provides information on the number and employee coverage of *new agreements* for the years 1997, 2000, 2005 and 2010. The table shows that retail agreements as a share of total agreements has grown significantly. Retail agreements accounted for just under 5 per cent of all *new* agreements in 2010 compared to between 1.2 and 1.6 per cent of all *new* agreements in the years 1997, 2000 and 2005.<sup>5</sup>

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<sup>5</sup> Prior to the September quarter 2007, retail agreements accounted for between 1 and 3 per cent of all *current* agreements and since then the retail share of all *current* agreements has averaged around 7 per cent (DEEWR Workplace Agreements Database).

In terms of employees covered, however, the increase has been much smaller (from 10 per cent in 1997 to 12 per cent in 2010). This reflects a fall in the average size of retail agreements (from a little over 1000 employees in 1997 to 329 in 2010), suggesting an increased propensity for small to medium-sized enterprises to negotiate enterprise agreements with their employees.

**Table 11.2 Number of new agreements and employees covered**

	<i>Agreements</i>		<i>Employees</i>	
	<i>Retail</i>	<i>All Industries</i>	<i>Retail</i>	<i>All Industries</i>
		'000		'000
1997	75	5.1	78 568	767.4
2000	85	6.9	59 363	720.4
2005	117	7.1	122 307	848.5
2010	401	8.0	131 894	1 089.2

Source: DEEWR Workplace Agreements Database.

Nevertheless, based on the latest data, the average agreement size in the retail industry remains high and is considerably higher than that for all industries (329 compared to 136 employees). Of the five largest private sector agreements by employee numbers, made in the period 1 January 2007 to 31 December 2010, three of them were in the retail industry (DEEWR Workplace Agreements Database).

Although the employee coverage of enterprise agreements in retail is now just over 40 per cent, the coverage of businesses is much lower. Business count data in chapter 3 shows that some 50 per cent of retail businesses have four or less employees and nearly 90 per cent employ less than 20 persons. Many smaller employers may perceive that the costs associated with forming enterprise agreements exceed the benefits. Nevertheless, of all federal retail enterprise agreements current at 31 December 2010, approximately 10 per cent covered four or less employees and nearly two-thirds covered 20 or fewer employees (DEEWR Workplace Agreements Database).

## **11.4 Wages and earnings outcomes and trends**

Statistical information and analysis of wages and earnings outcomes and trends, including some international comparisons of labour costs are presented in appendix C. Some of the key findings are outlined in this section.

- Employees in retail trade earn less on average than employees in most other industries — both in terms of average hourly and weekly earnings — reflecting

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the low average skill level of retail employees. The difference between average weekly earnings in the retail industry and all industries is also partly due to the much lower number of average hours worked by retail employees, and the higher incidence of junior rates of pay.

- Over the last decade, growth in retail industry wages and earnings (as measured by total hourly rates of pay excluding bonuses and by average weekly ordinary time earnings for full time adult employees) has consistently been lower than the average for all industries. In recent years, average wage increases negotiated under enterprise agreements in the retail industry have also been lower than the average across all industries.
- A number of submissions commented that Australia's wages, penalty rates and other non-wage labour costs are high relative to those overseas, for example in the United States and the United Kingdom. Much of the focus in submissions was on relative minimum wage levels which, although clearly high in Australia by comparison with other developed countries, tell us little about relative labour costs faced by retail employers.<sup>6</sup> International comparisons are problematic, and the retail-specific evidence appears mixed. Limited information in submissions and research by some private analysts suggests that labour rates for retail employees in certain larger listed Australian firms are significantly higher than for those employed by comparable retailers in countries such as the United States and the United Kingdom (see for example, Kierath and Wang 2011). On the other hand, the Commission's own analysis of wages and broader measures of labour costs (appendix C), as well as evidence presented by the ACTU (sub. DR180), would indicate that Australian employment costs are similar (for example compared with the United States) or significantly lower than many developed countries (for example the United Kingdom and several European countries), when expressed in common currency or purchasing power adjusted terms. It should be noted that relativities, based on comparisons of common currency equivalents, can be significantly influenced by exchange rate movements.
- However, most importantly when making international comparisons of labour costs, the relative productivity of workers, that is the relative contribution to output of retail workers in each country, must also be taken into account. Firm level and whole industry comparisons suggest that labour costs as a proportion of sales revenue/turnover in Australian retail are higher than in the United

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<sup>6</sup> The total cost of labour to a retail business comprises, in addition to base wages, award and above-award rates of pay and overtime, penalty rates and loadings, other allowances and non-money 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).

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Kingdom and the United States. The Commission acknowledges here too that international comparisons must be interpreted with caution (see appendix C).

Relative to many *less developed* countries, Australia's wages and associated 'on costs' are clearly high. This is largely a reflection of our generally high standard of living and the conditions of employment that Australians would generally be unwilling to compromise on. This sentiment is consistent with the view of the ACTU:

While it is true that retail sector wages are lower in some countries, the general community, unions and majority of employers do not support the 'race to the bottom' approach that would see Australian workers paid wages and conditions of workers in developing countries. (sub. 100, p. 3)

But compared to other Australian workers, the wages received by retail employees are low, a point emphasised in submissions from unions and numerous individuals. Some of these submissions also highlighted the difficulties faced by these workers and their families in meeting living expenses, particularly from their normal time earnings (see for example, United Voice sub. DR197).

The Commission has not, in this report, made any specific findings or recommendations in relation to pay and conditions. Moreover, the Commission accepts that cutting the pay and conditions of retail workers could potentially have detrimental impacts on productivity and the performance of the industry. This point was made by a number of participants. The ACTU stated that '[i]nvesting in decent wages and conditions assists employers to sustain a skilled and efficient workforce which delivers high quality customer service and solid returns' (sub. 100, p. 5).

However, it must also be recognised that, if those sectors of the Australian retail industry now exposed to international competition are to have the best chance of competing effectively, the productivity of workers will need to substantially narrow the gap with international competitors and more than keep pace with future wage movements.

Regulatory and workplace inefficiencies can contribute to total labour costs being high relative to retail output in Australia when compared to some other comparable countries. Part of the explanation for the lower total labour costs to sales ratio overseas appears to be higher labour productivity. This in turn is influenced by capital investments and the adoption of workplace flexibility initiatives, perhaps associated in some countries with the greater prevalence of performance-related pay in the overall structure of remuneration.

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## 11.5 Concerns about awards and labour costs

Some participants have raised concerns about the impacts of workplace legislation and awards on wage outcomes, workplace flexibility, productivity and employment in the Australian retail industry (box 11.4).

The main focus of this section is on the impacts of workplace regulation on what retail employers pay their workers, while the following section focuses in particular on those concerns that relate to workplace flexibility. However, clearly there is an overlap, for example, in relation to the impact of higher penalty rates on trading hours flexibility.

Some participants raised general concerns about the determination of minimum wages in Australia and recent minimum wage decisions (see for example ACCI, sub. DR196). These concerns are not considered in this report. The Commission recognises that many different factors must be weighed in making minimum wage determinations. Decisions are the outcome of an established public review process that provides an opportunity for stakeholder submissions to be considered. However, the following observations in the 2010 OECD Economic Survey of Australia are pertinent:

The challenge is to set the minimum wage at a level that minimises the potential employment losses relative to the income gains of lower paid workers (OECD 2009). Given the already relatively high minimum wage in Australia, future increases should be moderate and take account of productivity developments to avoid exclusion of vulnerable and low skilled workers. (OECD 2010, pp. 136-137)

### Minimum wages and incentive-based remuneration

Commissions and incentives do not appear to be a common feature of employee remuneration in Australian retail. However, the Commission understands that such arrangements are more prevalent and also more likely to be effective, in certain sectors of the industry (Shop, Distributive & Allied Employees' Association, sub. 18 and Unions WA, sub. DR185).

Participants have suggested that high minimum award wages are limiting retailers' flexibility to consider the adoption of incentive-based remuneration for their employees. Westfield, for example, submitted:

The high minimum labour cost precludes retailers from rewarding the best and most productive staff. This is a restraint on retailers' abilities to optimise resources in their businesses. Many retailers would like to offer incentives but the already high basic wages prevent them from doing so. (sub. 103, p. 23)

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**Box 11.4 Selected participants' comments on labour costs and workplace regulation**

**ACCI:** ... there are aspects of the Fair Work laws which are negatively impacting business in the services sector. These include one size-fits-all regulation and additional costs from 'modern' awards, a failure to tailor industrial regulation to the seven day nature of service industries, and a failure of 'individual flexibility arrangements' clauses in modern awards to markedly allow for individual employer-employee agreements. Other issues concern new rules around bargaining and agreement making, inflexible transmission of business rules, removal of exemptions which make it easier for employees to make unfair dismissal claims, increased capacities for unions to enter workplaces, the general re-regulation of industrial awards and removal of the capacity for an employer and employee to make individual agreements which suits the needs of both parties. (sub. DR196, p. 6)

**Myer:** Recent changes through the application of new 'modern awards' to penalty rates for late night and weekend work require increases to sales force employee pay from July 2011 and additional increases phased over the following two years. The impact to Myer from a cost perspective will be an additional \$10-15 million per year to operational costs over the next three years. This additional expense is on top of any proposed wage adjustment, thereby having the potential to 'double' labour costs within the organisation. This has the potential to cause a structural review of the composition of the Myer sales workforce and further impacts on the permanent versus casual mix and long term careers in the industry for those seeking the certainty of a permanent role. There are clearly potential unintentional consequences of such changes for careers in the retail sector. (sub. 88, p. 14)

**Australian Newsagents' Federation:** Approximately 65 per cent of newsagencies surveyed by the ARA suggested that the Fair Work system is the most, or a major, significant challenge to their business ... 'Newsagency operators anticipate that they will have to respond to the changes caused by the Fair Work system by cutting staff hours. ...' (sub. 99, p. 18, including quote from Australian Retailers Association, State of the Independent Retail Sector 2010, p. 33)

**Australian Retailers Association:** ... the requirement for retail businesses to comply with the Federal Government's Award Harmonisation process also places an added challenge to retailers as employers. Although the ARA do not propose in this submission to comment on what has been decided by the Parliament and the community on what represents fair workplace policy, the application of this does pose an additional problem to retailers. Specifically, the rising cost of labour required through Fair Work Australia does act as a disincentive to retailers to retain its relatively low-skilled workforce at a time when trading conditions are incredibly slow. Moreover, the productivity of workers in retail does not necessarily line up with the award harmonisation policies at a category-by-category level and, simply put, Australian retail is yet to show any signs of a sustained recovery. (sub. 71, p. 9)

**Retail Traders' Association of Western Australia:** Failure of our Federal IR legislation to properly understand and address the needs of the retail industry, to recognise the 24/7 activity within the industry, has caused significant increases to wage costs throughout the industry. We would see that this has not only offset previous productivity gains but led to a reversal of gains from the past. ...

To continue with the same practices and expect different results is the definition of insanity. ... Labour costs and IR issues are a large factor in any retailer's cost structure and therefore must be subject to scrutiny and change. (sub. 80, pp. 16-17)

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As pointed out by the ACTU, the FW Act does not preclude ‘an employer and an employee from entering into a common law contract placing some or all of an employee’s earnings ‘at risk’ — provided that over the course of an agreed period the employee is not disadvantaged in a financial sense compared to the award’ (sub. DR180, p. 16).

Further, the ACTU claims:

The main reason why these arrangements are not embraced is that the rewards offered by employers are not commensurate with the risks that employees are asked to bear. This is a market problem: if employers offered sufficient rewards, employees would no doubt be more interested in performance-based pay. (sub. DR180, p. 16)

Some enterprise agreements link remuneration with performance as a way of promoting improvements in productivity. Examples of performance-related wage clauses in enterprise agreements include performance pay arrangements for individuals, work teams or all employees and once-only conditional bonuses paid where certain performance or productivity levels are achieved (DEEWR 2010a). However, the incidence of such clauses is low in retail industry agreements (see section 11.6).

The payment of commissions is more widespread in the United States where base wages in equivalent retail activities are lower than in Australia. Participants to this inquiry have highlighted the potential productivity benefits of such performance-related remuneration:

The retail industry operates on extremely low margins and any factor that can bring lower overheads and related costs directly to sales would vastly improve productivity within the industry. Commissioned base remuneration would greatly assist the industry’s productivity especially with the expected international cost and price competition close at hand. It would put the Australian retail industry on a more level playing field with international competition. (Retail Traders’ Association of Western Australia, sub. 80, p. 17)

It’s very hard to pay commission in Australia which would probably improve productivity. It’s very hard to do here in Australia on the rates of labour you’re paying. But I’m sure that commission rates to employees would assist productivity. (ARA, trans., p. 17)

Myer supports the facilitation of an appropriate optional sales commission based remuneration system offsetting a proportion of the current ‘fixed’ cost system as it is our view that this drives improved productivity.

Such a scheme will ensure Myer is more competitive on a global scale and will help to manage the increasing presence of online retailing in Australia.

Myer is currently trialling performance-based pay for selling team members related to productivity targets. The initial sales uplift as well as positive feedback from both customers and team members is encouraging. (Myer, sub. 88, p. 15)

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The effectiveness of any incentive-based remuneration arrangements depend critically on their design and implementation and such arrangements may have greater potential to drive productivity improvements in some retail sectors than others. The Commission does consider, however, that the industry should continue to investigate opportunities for their more wide-spread adoption in Australia.

## **Impacts of award modernisation**

The process of developing modern awards that apply nationally, by combining the many state and federal awards, inevitably resulted in some changes in conditions of employment — in some cases increases, in other cases decreases. Some employers have raised concerns about changes arising from award modernisation that they claim are increasing their costs. These concerns are discussed below, but the modern awards will also provide employers (particularly those operating in more than one jurisdiction) with a number of benefits relative to pre-modern awards.

### *Benefits of award modernisation*

The award modernisation process will, over the next few years, result in more uniform award conditions, nationally. As noted by the Australian Newsagents' Federation:

... the introduction of the modern award system means that in some industries, such as retail, significant differences in wage rates and casual loadings in particular are being phased out. For example, in some states, casual loadings could be as high as 35% on top of the ordinary rate of pay, while in other jurisdictions, casual loadings were as low as 15%. (sub. 99, p. 33)

The head of the Australian Industry Group, has stated that 'the modern award system will provide many lasting benefits to employers, employees and the Australian community' (Ridout 2011, p. 4).

Union groups expressed the view that retail employer groups had failed in their submissions to adequately acknowledge many of the benefits flowing from award modernisation. The Shop, Distributive & Allied Employees' Association (SDA), for instance, highlighted the following benefits of the General Retail Industry Award:

- greater flexibility in terms of when and how ordinary hours can be worked:<sup>7</sup>

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<sup>7</sup> Additional rates of pay apply for overtime, that is hours worked in excess of the ordinary hours of work or outside the span of hours (excluding shift work) or roster conditions prescribed in clauses 27 and 28 of the General Retail Industry Award. Penalty rates are loadings that apply for ordinary hours (or all hours) of work on certain days or after a certain time on those days.

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The modern retail award provides for 24 hours, 7 days a week operation without overtime. This is the first time such a provision has applied. Under the numerous previous awards there were limitations on when and how ordinary hours could be worked, i.e. nightfill could only occur when the store was closed, “fill” ended at midnight, only one late night (evening) of work in a week could be rostered. A 24-hour trading store would have needed to use overtime rates to staff the store for substantial periods of the night and early morning. (sub. DR183, p. 9)

- it encompasses all classifications and categories of workers into the one award — anyone that a retailer would employ in a store (for example, bakers, butchers, payroll clerks, visual merchandisers) are now covered by the one award:

This not only reduces the number of awards at a store, but reduces the differing conditions that had previously applied, e.g. there is only one set of roster conditions applying, one set of rest break conditions, etc. This is also a significant productivity benefit for the industry, providing uniformity across Australia, easier application of conditions, a simpler understanding, no state differentials to deal with, and a simpler payroll system. (sub. DR183, p. 10)

- it has no limits on casual employment; no conversion of casual to permanent; allows part-time employees to agree to work additional hours up to full-time, without overtime; has no ratio or proportion of part-time or full-time employees; and allows employees to choose shift work or a penalty hour system or a combination of both, depending on their trading pattern, business structure or preference (sub. DR183, p. 11).

### *Employer concerns about cost impacts*

Some retail employers have stated that the implementation of the modern award will result in significant increases in their employment costs. This is notwithstanding the transitional arrangements contained in the General Retail Industry Award 2010, which mean that changes to wages, loadings and penalty rates are to be phased-in over a period of up to five years. The Victorian Employers’ Chamber of Commerce and Industry (VECCI), for example, submitted:

Despite Government commitments to the contrary, many employers — and, indeed, employees — are worse off as a consequence of the introduction of modern awards. The mechanism to relieve this — transitional or phasing arrangements in modern awards applicable to the sector — have themselves proven to be a kind of regulatory burden, and have made the task of award interpretation and application all the more complex. (sub. DR217, p. 4)

The National Retail Association (NRA) and the Australian Retailers Association (ARA) provided indications of the overall cost implications of the modern retail

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Shiftwork loadings generally apply to shifts starting at or after 6.00 pm on one day and before 5.00 am on the following day.

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award in their submissions to the 2010-11 Annual Wage Review. Using hypothetical case studies, the ARA suggested that, taking the first two transitional arrangements into account, weekly wage bills would rise by just over 5 per cent for a small Queensland retailer and by just over 3.5 per cent for a small NSW retailer (ARA 2011). The NRA, in its submission to the wage review, stated:

Taking into account the transitional arrangements, on average, national employers (operating across the various jurisdictions) engaging employees under the General Retail Industry Award 2010 were burdened with an increase in the order of 1.6% in their labour costs on 1 July 2010. For smaller employers who traditionally operate within states or territories (particularly NSW and Queensland) the increases were larger. (NRA 2011, p. 5)

The ACTU (sub. DR180) challenged the validity of both the ARA and NRA estimates. It questioned the representativeness of the case studies and assumptions on which they were based. It has not been feasible for the Commission to determine the accuracy of the estimates presented to the inquiry, nor to compile its own estimates of the likely overall cost impact on retailers of the introduction of the modern award. Cost implications vary significantly between jurisdictions and within jurisdictions, depending on the employment structure of individual businesses and the particular awards that applied prior to the commencement of the modern awards.

According to the NRA (2011), the main sources of increased labour costs in the modern award are: increased penalty rate provisions for weekend work (see below); increased casual loadings and allowances in some jurisdictions and increased basic rates of pay for particular classifications.

However, changes to certain conditions of employment in some jurisdictions will have offsetting benefits for employers that operate in the relevant jurisdiction (for example, a reduction in the casual loading in Victoria) and this needs to be taken into account when considering the overall net impact of the move to the modern award. These offsetting benefits are in addition to the general benefits cited above that have been argued are associated with national awards.

The ACTU noted, for example, that:

- in Victoria, labour costs overall have fallen significantly because of award modernisation
- for Australia as a whole, it estimates that retail wage rates for Monday to Friday work during the day, (based on a weighted average of relevant hourly rates in

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pre-modern awards) fell by 0.86 per cent for permanent adult workers and 2.12 per cent for casuals<sup>8</sup>

- ‘harmonisation also meant significant changes for wage rates that were ‘outliers’ in a national context. For example, the Sunday casual rate in the Northern Territory will decrease from \$34.90 to \$31.58 by 2015, ignoring the effects of annual minimum wage adjustments’. (sub. DR180, pp. 10-11).

Retailers have also expressed concerns about the combined effect of minimum wage increases and the changes resulting from award modernisation. For example, in its submission to the 2010-11 Annual Wage Review, the NRA stated:

The Minimum Wages Panel increased rates by \$26 per week from July 1, 2010. This represented a 4.33% increase for a shop assistant under the General Retail Award. This meant that, on average national retailers operating under the modern award would have been hit with a 6% increase in labour costs from July 1 last year (minimum wage increase plus modernisation increase). NSW and Queensland retailers would have been hit with a total increase around 7%. (NRA 2011, p. 5)

While those businesses with enterprise agreements will not be immediately impacted, there are concerns about the flow on effects over time:

The desire of employee representatives to maintain wage relativities between award and non-award employees means any decisions affecting award rates inevitably flows through to the wage negotiation process and becomes the minimum increase for any collective bargaining agreements. (ANRA, sub. 91, p. 36)

### *Penalty rates*

The biggest single industry concern in relation to the retail award modernisation process is the impact on penalty rates and, as a further consequence, on the trading hours flexibility of employers.

Penalty rates reflect a need to provide the typical worker with a higher level of compensation for their services at times when the opportunity cost of their time, for example in terms of caring responsibilities, family time or other leisure activities, may be greater. Without this added incentive, many workers would prefer not to work at times they consider to be ‘unsociable’ or otherwise inconvenient. It is also the case that ‘[m]any workers rely on penalty rates to make ends meet and any reduction in penalty rates would have a significant impact on the finances of thousands of households’ (Unions WA, sub. DR185, p. 4).

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<sup>8</sup> These are weighted averages based on retail employment by state and various assumptions, including about previous award coverage and the proportion of workers employed in non-constitutional corporations — see ACTU, sub. DR180, p. 10 for details.

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The following comments are indicative of industry concerns about penalty rates in the modern retail awards:

The Award doesn't reflect or address the need for flexible hours to meet the convenience and other needs of our consumers. Penalty rates are at unsustainable levels and have inflicted large cost increases over those under previous legislation. (Retail Traders' Association of Western Australia, sub. 80, pp. 16-17)

From July 2011 our business will be facing increased penalty rates for night and weekend work as well as increased casual loading rates. ... These ... increases will directly impact our businesses and will likely result in our brands having to reduce employee numbers in order for stores to remain profitable. ...

The peak shopping periods are weekday late nights (such as Thursdays) and weekend days. Yet due to penalty rates (which can be as high as 250% of the standard rate) retailers are restricted in the way they can structure employees during this time. (Adairs Retail Group, sub. 129, pp. 1-2)

The Guild shares the concerns of other retailers with regard to the impact of penalty rates contained within the modern awards for retail, including the Pharmacy Industry Award 2010 ... (The Pharmacy Guild of Australia, sub. DR181, p. 5)

Retail employers raised concerns about penalty rates and hours of work provisions and their cost implications during the early development process for the modern award, and subsequently through applications to vary the Award provisions (box 11.5).

Table 11.3 summarises the penalty rate structure in the General Retail Industry Award. Producing a comprehensive mapping between pre-modern award penalty rates in the many relevant state and federal awards and those applying in the modern retail awards is a complex task and the Commission understands from its consultations with the relevant agencies that summary information is not readily available. The SDA, however, did provide the Commission with information on weekend penalty rates in relevant pre-modern awards (table 11.4).

Corporations formed after 27 March 2006, and prior to the commencement of modern awards, were permitted to operate under the Australian Fair Pay and Conditions Standard, including the applicable Australian Pay and Classification Scale. Such businesses were not subject to the provisions of awards and no penalty rates applied to these businesses. Although the number of businesses affected is likely to be comparatively small (ACTU, sub. DR180), from 1 July 2010 they were, for the first time, required to pay penalty rates.

... these businesses have moved from no penalty rate to a 5% penalty rate on Saturdays, from no penalty rate to a 10% penalty rate on Sundays and no penalty rate to a 50% penalty rate on Public Holidays. (NRA 2011, pp. 7-8)

### Box 11.5 Applications to vary retail award provisions

Parties lodged a total of 12 applications to vary the Retail Award under the variation provisions of the Workplace Relations Act which ceased operation on 1 January 2010. Key applications included:

- on 30 September 2009, the NRA lodged an application to vary Retail Award provisions regarding part-time work, uniform allowances and penalty rates
- on 14 October 2009, the Chamber of Commerce and Industry – WA applied to vary the Retail Award in relation to clauses on part time work, maximum ordinary hours, rostering and overtime.

FWA's decision of 29 January 2010 varied the Retail Award in order to deal with the majority of applications made by parties including the two key applications listed above. With respect to penalty rates, the decision resulted in the removal of the casual loading for casual employees working on Sundays. Prior to this decision, casual employees under the Retail Award were entitled to receive a total pay rate of 225 per cent of their ordinary rate on Sundays. This included the casual loading of 25 per cent in addition to the Sunday penalty rate (which also applies to permanent employees) of 100 per cent.

Since the commencement of the national workplace relations system on 1 January 2010, there have been 20 applications made to vary the Retail Award. These applications have included concerns about issues such as minimum engagement periods, alterations of ordinary hours, or to otherwise remove ambiguity or uncertainty in particular clauses in the award. However, none of the applications specifically address the issue of penalty rates.

Source: DEEWR, pers. comm., 13 September 2011.

Table 11.3 Penalty rates in the General Retail Industry Award

	Penalty rate (after transitional arrangements)	
	Permanent employee	Casual employee
Evening work Monday to Friday	25%	0%
		(25% casual loading applies)
Saturday	25%	10%
		(25% casual loading applies)
Sunday	100%	100%
		(no casual loading)
Public holidays	150%	150%
	(or leave in lieu equivalent)	(or leave in lieu equivalent, 25% casual loading applies)

Source: General Retail Industry Award 2010.

**Table 11.4 Pre-modern retail award weekend penalty rates**

Permanent employees

<i>State/territory</i>	<i>Saturday</i>	<i>Sunday</i>
Victoria	Between 25% and 36%	100%
New South Wales	25%	50%
Queensland	25%	100% (except 50% in independent stores)
ACT	Extra \$ added to weekly pay: Work before Noon \$18.70 Work after Noon \$22.50 Work both morning and afternoon \$41.20 (between 26% and 40% loading depending on number of hours worked)	50%
Tasmania	50%	100%
South Australia <sup>a</sup>	0%	60%
Western Australia <sup>a</sup>	Loading equivalent to 21%	100%
Northern Territory	25% before Noon Frozen flat amounts for between Noon and 6.30 pm. Frozen until they equal 25% (About 35%)	100%

<sup>a</sup> SA and WA had significantly higher base rates for hours worked Monday to Saturday.

Source: SDA (sub. DR223).

The union groups pointed out that other factors must also be taken into account when considering the cost implications of penalty rate changes:

... many retail employees lost in an instant a substantial component of their regular wage due to the fact overtime was not a “penalty” and therefore was not phased in or out. It was simply removed. To illustrate this, in many states work between 6 pm – 9 pm Monday – Thursday was overtime. Retail workers regularly worked this time, e.g. supermarkets open to 8 pm. Employees working between 6 pm – 8 pm were paid a 50% overtime penalty. With the new award span of hours allowing work after 6 pm with a penalty of 25%, a ‘transition’ is to occur. This transition however is from 0% to 25% over five years as the overtime penalty was not saved. FWA and FWO have both agreed this is correct, so employers could freely trade to 8 pm, no longer pay the overtime penalty, do not have to pay the full 25% penalty, but enjoy a five year phase-in of the transition from 0 to 25%. Currently, a transition penalty of 10% applies. This is substantially less than what workers previously received. (SDA, sub. DR183, p. 10).

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In WA, due to the Shop and Warehouse Award treating Sunday as an overtime day, and the transitional provisions not dealing with overtime, the effective penalty rate on Sundays for employees in General Retail shops went from 100% to 20% and currently sits at 40%. Furthermore, the weekly base rate of pay under the General Retail Industry Award when it took effect was actually lower than that provided under the WA Shop and Warehouse Award. (Unions WA, sub. DR185, p. 6)

Unions also pointed out that ordinary hours in the General Retail Industry Award are far in excess of hours that are standard in the awards in other industries and penalties are not ‘as high as in many other industries that operate 24/7’ (SDA, sub. DR183, p. 6).

SDA also noted that penalty rates were lower, and the span of ordinary hours broader, in the general retail award than some other retail awards, such as the Vehicle Manufacturing, Repair, Services and Retail Award.

The ACTU claim that penalty rates in Australia are moderate by international standards (trans., p. 42). The Commission has undertaken a comparison of compensation for work on rest days and public holidays in selected OECD countries (appendix C). This indicates that some countries such as Finland and France have relatively generous compensation provisions. However, relative to some other countries penalty rates are high in Australia. Further, penalty rates do not apply at all in retail in most states in the US.

Some retailers, in their submissions, suggested that the modern award failed to adequately reflect today’s reality of extended retail trading hours. Woolworths, for example, stated:

Australian retailers are constrained by the assumption that shopping still occurs Monday to Friday between 9am and 5pm which is reflected in the General Retail Industry Award. (sub. 110, p. 14)

In responding to the draft report, the SDA pointed out that such statements were misleading:

The modern General Retail Award provides for ordinary hours on all days of the week. Clearly a spread of seven days a week shows that a claim of a Monday to Friday restriction is incorrect. The Retail Award has a span of Monday to Friday, 7am to 9pm (11pm for those employers who open beyond 9pm Monday to Friday, or 6pm on Saturday or Sunday), Saturday 7am to 6pm and Sunday 9am to 6pm. Further the modern Retail award has a night shiftwork provision.

A simple look through the awards in other industries shows that retail ordinary hours are far in excess of hours that are standard. (sub. DR183, p. 5)

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That said, given the significance of weekend trade for some businesses, any increases in penalty rates can have significant cost implications. The NRA have stated:

Weekend trading will be the peak trading and staffing periods for many operators and simple modelling will show that if labour costs increase by 25% on Saturday and 50% on Sunday — the impact across the week will be in the order of 20%. ...

For small businesses in particular this increased penalty will mean that trading hours will be reduced and/or owners will work more hours in the business. (NRA 2011, pp. 4-5)

In principle, penalty rates in awards should not be set in excess of the minimum necessary to avoid unfair or unduly harsh treatment of employees, and an efficient level of penalty rates would be one which is just sufficient to induce people with appropriate skills to voluntarily work the relevant hours. Some workers may be very comfortable with (or even prefer) weekend and evening work and, for these people, the additional pay incentive may not need to be as large as exists under the current penalty rate structure. If work at existing penalty rates is keenly sought, this may also be suggestive of those rates being higher than is necessary to compensate workers for working at times that are inconvenient.

... there are some people in the retailer industry who would be very happy to work on weekends and public holidays and yet they are not really looking for higher wages. It would suit their lifestyle to be able to work on weekends ... (ARA, trans., p. 5)

It is especially ridiculous to be required to pay penalty rates to school kids, since it is not a penalty for them to be working on a weekend; in fact in many cases those are their preferred days of work. (Eltham Valley Pantry, sub. 9, p. 7)

... ANRA members report that they have no difficulty finding volunteers to fill shifts on public holidays and weekends, with many employees welcoming the flexible working arrangements that retailing offers. For example, Easter Sunday bears no significance for non-Christian employees who may welcome the opportunity to earn penalty rates. (ANRA, sub. 91, p. 21)

The use of penalty rates affects the relative costs of doing business at different times of the day or times of the week and therefore influences decisions about trading hours. Faced with growing competition from online businesses that are accessible to consumers 24 hours a day, 7 days a week, retailers are keen to extend their trading hours for the convenience of their customers. Myer, for example, stated:

Most of the sales that are achieved by Myer are during the higher penalty rate periods, when more customers are choosing to shop requiring more labour, proportionately, to be rostered during these higher cost periods adding to our cost base. (sub. 88, p. 15)

According to the Pharmacy Guild of Australia, extended and seven day a week trading patterns are required in the community pharmacy sector 'to meet the

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expectations and health care demands of customers and patients' (The Pharmacy Guild of Australia, sub. DR181, p. 4).

However, some retailers are making the decision not to trade at times now permitted under deregulated or substantially liberalised shop trading hours (chapter 10), largely because penalty rates make it unprofitable for them to do so:

Some small-medium retail enterprises, we are being told now, are closing on weekends, particularly in country areas, particularly on Sundays due to the incredible cost of the wages that are needed to be paid by employers to senior full-timers. (ARA, trans., p. 5)

Recent changes to the General Retail Award affect the costs of the business which then impacts on opening times of bicycle shops. (Retail Cycle Traders Australia, sub. 57, p. 8)

Even with deregulation of trading hours, labour laws prevent many retailers from profitably trading late nights, or on Sundays and public holidays. (Westfield, sub. 103, p. 34)

Submissions from union groups (for example, see SDA, sub. DR183 and the ACTU, sub. DR180) noted that some of their members depend on penalty rates to increase their take home pay. However, if penalty rates discourage retailers from trading at times penalty rates apply, or when retailers do trade they employ mainly junior casuals (ARA, trans., p. 15), the hours worked and take home pay of many employees could decrease as could overall employment levels. Thus a balance needs to be struck.

Many businesses are therefore calling for greater flexibility, including in awards:

Woolworths believes ... that it would be appropriate to undertake a review of the penalty rate arrangements contained in that [the General Retail Industry] Award to ensure that retailers are able to have flexibility to employ and use their staff in a way, and at times, that best serve the needs of customers. (Woolworths, sub. 110, p. 16)

... both trading hours and labour laws need revision to ensure that the Australian retail sector is prepared for the changes in shopping behaviour that are upon it. There should be flexibility for retailers to trade when they choose, and there should be employment opportunities available for those people that cannot or choose not to work conventional hours. (Westfield, sub. 103, p. 34)

The modern retail award does not restrict retailers' flexibility in terms of when they can trade. Penalty rates in the award do, however, impact on the relative attractiveness of trading at different times. Because attitudes towards extended or late shifts and weekend and public holiday work will vary from workplace to workplace, penalty rate and other related provisions set in awards are unlikely to be optimal for many enterprises. The default penalty rate regime set by the modern award can be modified through enterprise bargaining. Indeed, a key focus of

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enterprise bargaining in the retail industry has been to reduce or remove the distinction between ordinary hours and hours which attract penalty rates.

However, as will be discussed below, there is scope for increased enterprise-based bargaining in the retail industry and within enterprise agreements for the more widespread adoption of flexibility provisions. But some aspects of the FW system, such as the operation of the better off overall test, may be inhibiting the adoption of flexibility enhancing provisions (section 11.6).

### *Other concerns about awards*

A key objective of the streamlining and simplification process has been to make awards easier for employers to interpret and administer. As well as providing simple and clear directions for employers, the use of plain English in awards is intended also to assist employees to understand their entitlements.

Nevertheless, in practice, some employers and employees are having trouble understanding their obligations and entitlements under awards. In particular, as a result of the current modern award transitional arrangements, employers are experiencing difficulties determining appropriate pay scales/wage rates:

The phasing provisions are, like the modern awards themselves, ripe with technical complexity and interpretative uncertainty. (VECCI, sub. DR217, p. 4)

The new Award changes are quite frankly a mess and complicated to input due to incremental changes to all rates over 4 years. This legislation was supposed to make it easy for employers and employees alike to digest the changes however it is just creating greater ambiguity and confusion for all. (Red Herring Surf, sub. 41, p. 8)

Where are the wage tables which can be easily understood and applied by employers? They do not exist. (Eltham Valley Pantry, sub. 9, p. 8)

The difficulty of calculating wage rates during the modern award transition phase, which is also a problem in other industries where transition arrangements apply (SDA, sub. DR183), is illustrated well by the example provided by the Australian Newsagents' Federation (box 11.6).

Employers have also, in some instances, experienced difficulty getting sufficient or consistent advice applicable to their specific circumstances from the Fair Work Ombudsman (FWO). Consequently, some have reported that they face additional compliance costs, including expenses related to obtaining legal and other professional advice:

There are many different interpretations out there between Fair Work and Employer Bodies nothing appears easy and this makes it even harder to forecast wage budgets for upcoming financial years. (Red Herring Surf, sub. 41, p. 8)

### Box 11.6 Difficulties determining applicable wage rates

These difficulties arise out of the transitional provisions that have been implemented as a result of the introduction of the modern award system, and make calculating wage rates an incredibly fraught process. It requires the employer to know what the wage rate was at 31 December 2009, what it was in the modern award on 1 January 2010, and to take into account all increases in minimum wage rates since that date.

For example, if a shop assistant was paid \$15.00 per hour until 31 December 2009 (the pre modern rate), but from 1 January 2010 the minimum rate of pay for that work was \$16.00 per hour under the modern award, the employer would need to perform the following calculation to determine the current minimum rate of pay:

- First calculate the transitional amount by determining the difference between the two rates:  $\$16.00 - \$15.00 = \$1.00$  per hour. Then divide the transitional amount by 5 to determine the annual amount by which the wage rate would increase —  $\$0.20$  per hour
- Then take the pre-modern rate and add the relevant proportion of the transitional amount -  $\$15.00 + \$0.20 = \$15.20$  per hour
- Next, add in the increase in minimum wages for adults from 1 July 2010 of  $\$0.69$  per hour —  $\$15.20 + \$0.69 = \$15.89$  per hour.

This process has to be repeated each year until 1 July 2014, so from 1 July 2011, two fifths of the difference between wage rates needs to be factored in to the calculation and then the minimum wage increase for 2011 must be added. So employers must then calculate the wage rate from 1 July 2011 as follows:

$\$15.00$  (pre modern rate) +  $\$0.40$  (two fifths of the transitional amount) +  $\$0.69$  (minimum wage increase for 2010) +  $\$x.xx$  (minimum wage increase for 2011).

This convoluted method of transitioning disparate wage rates from pre-modern awards to consistent rates across the nation has come about because the award modernisation process had terms of reference that required that increases in costs to employers and decreases in entitlements for employees had to be minimised. Ultimately, although employers are having wage rate differences phased in over five years, the administrative costs to the employer in determining enforceable minimum wage rates are significant — either the employer must do this themselves, or they must pay an employer association to do this (and the employer association then incurs significant costs in the calculation and must pass these costs on to members) or the employer simply pays a higher rate of pay to avoid having to consider the issue.

The impact of this complexity on productivity within a business cannot be underestimated.

Source: Australian Newsagents' Federation (sub. 99, pp. 32-33).

There are too many circumstances that we've come across where, not for any reason other than the basis of their advice is unclear, we have had differential advice going to employee and employer. It's the capacity to be able to have that advice consistent and reliable that has to be built into the process and that is not currently there. It's not until you interrogate some of the advice that's been given that you realise why it is incorrect or inconsistent. It's really the way in which that advice is being provided that creates that conflict. (Restaurant & Catering Australia, trans., pp. 391-392)

At present, one is required to belong to an industry association if one is to administer an industrial award with confidence. This costs hundreds of dollars each year.

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Fair Work Australia (or the equivalent body) should articulate employer obligations in an easily understandable form on their web site or their information line and not have to resort to the line ... 'you'll have to consult a lawyer to get that information'. (Eltham Valley Pantry, sub. 9, p. 8)

With respect to the concern about consistency, the Commission notes that the telephone advice provided by the FWO to employers and employees relies on the information provided by the caller, the accuracy which cannot be tested by the FWO. Employers and employees at times may have differing views on matters that will directly impact on the advice — a different interpretation or understanding of the employees' duties, for example, could change advice on rates of pay. This may explain, in some cases, perceived inconsistencies in the advice provided by the FWO.

There are limits on how simply terms in awards can be expressed, because awards are legally enforceable documents specifying the minimum obligations of employers and employees. Beyond a certain point, simplification may lead to provisions that are ambiguous and uncertain. That said, any *unnecessary* complexity or ambiguity in awards can impose a significant burden on employers and it is important that Fair Work Australia addresses this wherever possible.

Changes to awards can also have significant administrative cost implications for employers. Smaller firms in particular can find the costs burdensome, for instance those related to updating payroll software and manuals. Myer also noted that employers are required to communicate to staff details of changes to workplace regulation and their implementation and that this can be a substantial cost impost 'borne by the employer rather than at the Government level where the change originates' (sub. 88, p. 15). Myer provided the following example:

Myer was required to issue a *Fairwork Australia* information statement to over 13 000 team members in 67 Stores across the country. The cost of distributing such paperwork was approximately \$10 000. (sub. 88, p. 15)

With respect to determining applicable rates of pay, it is essential that employers are able to ascertain and apply the appropriate pay rates without incurring significant time and other compliance costs. However, the Commission understands that the transitional arrangements have introduced a degree of complexity that makes the publication of simple tables problematic. Tables would need to cater for a large range of individual circumstances depending, for instance, on the award and particular classification that applied to any employee prior to the modern award.

To assist employers and employees to calculate rates of pay, the FWO has developed a suite of online tools. These include PayCheck Plus, Award Finder and Pay and Conditions Guides for pre-modern awards. PayCheck Plus, for example,

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(which replaced previous tools, PayCheck and Payroll Check) calculates base rates of pay, allowances, overtime, and penalty rates for a particular job, based on the employer's response to a series of questions. It takes into account the modern award classification and the corresponding pre-modern award classification and automatically factors in transitional provisions and changes resulting from Fair Work Australia's annual wage review. Rates of pay can also be obtained for entire shifts worked over a seven day period, as well as multiple rates of pay for different staff under multiple award classifications.

The concerns about the difficulties calculating wage rates may to some extent reflect 'teething problems' associated with a new system. While this was recognised in the draft report, the Commission recommended that the FWO should address the difficulties experienced by employers in calculating wage rates through better promotion of its existing services and, where necessary, by making refinements to existing systems.

With the benefit of further consultation with the FWO and advice about refinements it has made (pers. comm., 16 September 2011), particularly to its online assistance tools, the Commission considers that a recommendation is not warranted in this final report. However, the FWO should continue to provide assistance to employers in calculating applicable award wage rates, including by ongoing promotion of its existing online tools, telephone advisory services and education activities. It should also continue to respond to feedback from users of these services and consider whether further improvements to systems need to be made.

While the small number of concerns raised about the advice being given by the FWO does not suggest any systematic problems, particularly given the extremely large volume of queries handled by the FWO, it is vital that staff providing advice to employers and employees on pay rates and other award matters are well informed and appropriately trained, and provide consistent advice.

Some participants have also raised concerns about the impact on workplace flexibility of new award provisions stipulating minimum duration shifts. This and other flexibility issues are covered in the next section.

## **11.6 Workplace flexibility**

The flexibility to tailor workplace practices and employment conditions to the circumstances of individual retail firms and employees has potential benefits for both groups, and for the economy as a whole. Greater flexibility can improve the productivity of labour and reduce employers' unit labour costs (that is, labour costs

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for a given unit of output or level of sales). For employees, it can provide greater choice about the way they organise their work and family responsibilities, improve working conditions and increase job satisfaction.

The following comments by the Commission — made in a submission to a 2009 Parliamentary Inquiry into raising productivity growth — are salient in light of the current evolution of the retail industry in Australia:

While industrial relations regulation addresses legitimate concern for workers' basic rights based on community norms, it is important to preserve the ability of organisations to engage effectively with employees to change work arrangements in response to commercial imperatives. As the economy changes, different firms and industries will come under divergent pressures in a way not amenable to enforcement of common employment conditions, as the recent debate about the special circumstances of the hospitality sector illustrates. Flexibility in employment arrangements can yield significant benefits for employees as well as their employers. (PC 2009d, p. 43)

Flexible workplace arrangements enable firms to adapt more readily to changing circumstances, for example to meet changes in demand by:

- adjusting the workforce size either through engaging or dismissing employees, the short-term use of casuals or contracting out of functions traditionally performed in-house
- varying the scheduling and intensity of use of the existing workforce — strategies include flexible rostering for overtime and shift work and scheduling rostered-days-off and annual leave to coincide with low demand (and for employees, the ability to reconcile work and non-work commitments by adjusting the timing and duration of work)
- moving labour between functional areas — this strategy requires that workers have both the skills and willingness to move between tasks and requires the removal or reduction of any barriers that may exist
- linking remuneration, and therefore unit labour costs, to product demand/output rather than hours worked — approaches include sales commissions or incentives and bonus or profit sharing schemes
- providing the incentive, in other ways, for employees to offer outstanding customer service, find innovative ways to enhance the shopping experience or generally make the retail operation work more efficiently.

The flexibility that Australian employers had under workplace laws — for example, to cut back employee hours and to require workers to take their annual leave — when dealing with the impact of the global financial crisis and economic downturn, has been credited with minimising job losses and the survival of some marginal

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businesses (see, for example, Plumb et al. 2010). Flexible workplaces will be critical as the economy and the retail industry deals with an ageing workforce and skills shortages, as well as shifts in consumer demand. Awards and agreements will need to offer the flexibility to offer mature aged persons employment conditions that match their needs, for example shorter shifts or perhaps the ability to negotiate various pay/productivity arrangements. The ANRA commented:

Part-time and casual work is likely to play a greater role for Australians seeking work during the later stages of their working life and during the transition into retirement. (sub. 91, p. 35)

Nevertheless, workplace flexibility will not always be welfare enhancing from a broader perspective. For example, increased employer discretion over when and how many hours an employee works will only generate net benefits overall if the increased productivity benefit over time exceeds the cost borne by the employee as a result of having less certainty or control — for instance, from not having a regular schedule, having working hours that are arduous, or not knowing what their income will be from week to week. Some employers, in the absence of any constraints, might wish to implement changes that they perceive to be good for their business, but may be detrimental or unfair to their employees. This could include changes such as abolishing penalty rates (without compensation), or having complete flexibility to determine rostering (including, for example, expecting staff to be on call). This essentially amounts to shifting part of the employer's adjustment costs to employees.

However, where workers have freely (without coercion) agreed to workplace changes, it can generally be presumed that the benefits to them (including any offsetting compensation) outweigh any loss. Formalised 'no-disadvantage' or 'better off overall' tests are designed to ensure that workers are fully compensated for any conditions they have traded off in negotiations.

Not surprisingly, there are many employees who desire a greater level of flexibility in their working conditions than they are able to negotiate with their employer. This is taken up further in chapter 12.

The rest of this section examines the scope for firms to develop flexible workplace arrangements under the new workplace relations system, and the extent to which employers in the retail industry appear to have taken advantage of the opportunities that existed prior to the commencement of the FW Act. While unions contend that 'there is already sufficient flexibility in the current industrial relations framework to meet individual employer needs' (ACTU, sub. 100, p. 2), some employers have indicated that workplace regulation is impacting on their ability to flexibly adapt to a changing retail market in Australia.

## Individual flexibility arrangements

Although statutory individual contracts are not permitted under the FW Act, the new legislative framework seeks to promote workplace flexibility through the use of individual flexibility arrangements (IFAs).<sup>9</sup> Every modern award and enterprise agreement must include a ‘flexibility term’ which allows an employer and an individual employee to voluntarily agree on an arrangement which varies the effect of the award or agreement to meet their needs (box 11.7).

To ensure minimum entitlements are not undermined, the FW Act requires that the employee is better off overall on the IFA compared to the award or enterprise agreement. If an enterprise agreement does not include a flexibility term, it will be taken to include the model flexibility term set out in the Fair Work Regulations 2009.

Table 11.5 provides summary information on the inclusion of flexibility terms in enterprise agreements from DEEWR’s Workplace Agreements Database. Retail has a significantly lower incidence of specific flexibility clauses than the average across all industries.

**Table 11.5 Flexibility terms in FW Act agreements lodged between 1 July 2009 and 31 December 2010**

	<i>Retail</i>		<i>All Industries</i>	
	<i>Agreements</i>	<i>Employees</i>	<i>Agreements</i>	<i>Employees</i>
	%	%	%	%
Model flexibility clause or greater <sup>a</sup>	88.5	89.8	62.4	63.1
Specific flexibility clause	12.4	10.3	39.4	39.0
<b>Total<sup>b</sup></b>	<b>100.9</b>	<b>100.1</b>	<b>101.8</b>	<b>102.1</b>

<sup>a</sup> This includes agreements containing the model clause, agreements where the model clause has been incorporated by FWA, agreements containing a term that allows individual flexibility agreements about any matter in the workplace agreement and agreements where no flexibility term is present. The model flexibility term allows for individual flexibility agreements (IFAs) about one or more of five listed matters under a workplace agreement (see box 11.7). <sup>b</sup> The flexibility term data totals more than 100 per cent because agreements may contain more than one such term.

Source: DEEWR Workplace Agreements Database.

<sup>9</sup> Under the *Workplace Relations Act 1996*, formalised written agreements between an employer and an individual employee, setting out terms and conditions of employment, were called Australian Workplace Agreements (AWAs).

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### Box 11.7 Individual flexibility arrangements

An employer or an employee can initiate a request for an individual flexibility arrangement (IFA). An IFA has effect, and is enforceable, as if it were a term of a modern award or enterprise agreement. It must be in writing and signed by the employer and employee (and also a parent or guardian where the employee is under 18). IFAs do not need to be approved by FWA, and it is not a requirement that unions be involved, but it is recommended that employers allow employees to be represented by a third party if they wish when negotiating with their employer.

Generally, an IFA may be terminated by agreement or by either party giving the required written notice — 28 days for modern awards, or as specified in an enterprise agreement (but not more than 28 days).

#### *Modern award flexibility terms*

Flexibility terms within modern awards will only allow IFAs to vary:

- arrangements for when work is performed such as working hours
- overtime rates
- penalty rates
- allowances
- leave loading.

An example: Dave wants to coach his son's under 10s football training on Tuesday afternoons. Dave makes an IFA with his employer allowing him to start and finish work half an hour early on Tuesdays without the usual penalty rate that would apply for the first half hour. (FWA 2010, p. 2)

#### *Enterprise agreement flexibility terms*

The matters included in the flexibility term must be decided by the parties when the enterprise agreement is made. IFAs varying enterprise agreements may include terms which would be 'permitted matters' if they were included in the enterprise agreement. This includes: matters pertaining to the relationship between the employer and employees or between the employer and a union covered by the agreement; deductions from wages (e.g. salary sacrifice deductions); or the operation of the agreement. The unvaried enterprise agreement continues to apply to employees unaffected by the IFA.

Source: FWO (2011).

Some employers have found that it is proving difficult, in practice, to achieve worthwhile productivity improvements through the negotiation of specific flexibility arrangements with individual workers.

ACCI is concerned that IFAs are not delivering sufficient individual flexibility as promised (sub. DR196, p. 23)

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More often than not, the outcomes of flexibility terms in enterprise agreements and modern awards have led to reduced flexibility for employers. (Victorian Employers' Chamber of Commerce and Industry, sub. DR217, p. 2)

IFAs promised so much but in reality they have not proved to be a meaningful replacement for the flexibility provided by AWAs. (Ridout 2011, p. 8)

Purported constraints limiting the effectiveness of IFAs, include:

- employers have difficulty assessing, with any certainty, whether a particular IFA meets the 'better off overall' test (discussed below).

Employers are discouraged to utilise an IFA in the manner purported in the EM [Explanatory Memorandum] or FWO examples ..., as there is an element of risk and they may be breaching the award terms should a court conclude that the IFA does not meet the 'better off overall test' as against all award conditions. (ACCI, sub. DR196, p. 23)

... if the terms of the IFA are subsequently deemed to include financial detriment to the employee compared to the Modern Award the business may be subjected not only to retrospective pay adjustments but a monetary penalty of up to \$33 000 for breaches of the Fair Work Act 2009. With such high stakes involved R&CA argue IFA's should be renamed to 'Inflexible Fake Agreements'. (Restaurant & Catering Australia, sub. DR193, p. 9)

- the FW Act prevents employers offering IFAs as a condition of employment
- employees can cancel them with just four weeks' notice:

Few employers would be prepared to reach an IFA with an employee and pay a wage increase in return for certain flexibilities, when the employee can give four weeks' notice and cancel the agreement. (Ridout 2011, p. 8)

- some unions have tried to limit the uptake, or narrowed the scope and potential benefits, of IFAs:

... a number of trade unions have engaged in an industrial strategy of limiting the use of Individual Flexibility Arrangements (IFA) in enterprise agreements and opposing agreements where they contain an IFA that is as flexible as the default regulation model clause or the model clause in modern awards. ...

There are also union IFA clauses that require a majority of the workforce to agree to changing the application of certain conditions in an agreement. This is equally offensive to the principle that IFAs were supposed to be available to individual employees and their employer. ...

Unions are limiting the number of matters an IFA can deal with in bargaining and rendering it fundamentally ineffective as a vehicle for promised flexibility. (ACCI, sub. DR196, p. 24)

For such reasons, the Commission understands that employers generally may not to date have embraced IFAs as a practical alternative to a workplace agreement. But

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unions too have concerns about certain aspects of the operation of IFAs. The ACTU stated:

... there is anecdotal evidence that employers — including those in the retail sector — are continuing to treat IFAs as if they were AWAs. In particular, we have several reports of employers either informing job applicants that they ‘must’ sign an IFA, or else simply providing a copy of the IFA with the contract of employment and Tax File Number declaration at the start of employment, without explaining that employees are not obliged to sign the IFA.

Secondly, we have reports (including from the pharmacy sector) of employers offering IFAs that remove penalty rates, but which state that in return the employee will be given the ‘flexibility to work the hours that suit the employee’. Clearly, this arrangement cannot leave the employee ‘better off’, since they will have incurred a financial disadvantage. (sub. DR180, p. 18)

The evidence above suggests that there may be scope to improve the operation of IFAs. It is recognised, however, that the arrangements are still relatively new. Under the FW Act (s. 653), the General Manager of FWA is required to conduct research into the extent to which IFAs are being agreed to, and the content of those arrangements, every three years. The first reporting period ends in May 2012, with a report due within six months of that date (s.653(2)).

### **Flexibility under awards**

Over time, awards have become more streamlined and generally less prescriptive or restrictive and it has been argued that the modern awards offer ‘enhanced flexibility in comparison to some previous state awards’ (Shop, Distributive & Allied Employees’ Association, sub. 18, p. 6).

However, because awards are negotiated at the industry rather than enterprise level, they are not tailored to the circumstances of individual firms or employees. Several submissions suggested modern awards provide insufficient flexibility for employers, for example:

ARA is of the view that the ‘one size fits all’ structure of the current award is fundamentally failing to allow for the flexibility required to promote growth in the industry. (sub. DR162, p. 8)

There is a real question mark as to how modern, flexible and productivity enhancing, modern awards are for employers and employees. ...

[Modern awards] are inherently inflexible as they operate on a ‘one-size fits all’ approach and were arbitrated following long forgotten disputes of decades past. The services sector is extremely diverse and dynamic and such inflexible labour rules do not reflect the evolution of the sector [or] the specific needs of firms. (ACCI, sub. DR196, p. 11)

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Recent FWA research based on firm-level analysis has highlighted possible implications of awards for productivity and profitability:

... relative to firms that utilised non-award arrangements and firms that used a combination of award and non-award arrangements, firms that paid only award rates were less likely to experience increased productivity and profitability ... Furthermore, the results revealed that firms that paid only award rates exhibited lower survival rates relative to their counterparts. (Farmakis-Gamboni and Yuen 2011, p. 79).

The Commission notes that in such analysis it can be difficult to identify the specific impact of changes to workplace arrangements with confidence. This and other factors impacting on the reliability of the findings were acknowledged by the authors:

... the subjective nature of some of the measures used adds more uncertainty to these findings and the direction of causality remains ambiguous, as these data highlight only associations between firms that paid award rates and their productivity, business competitiveness and viability. (Farmakis-Gamboni and Yuen 2011, p. 79)

Notwithstanding potential benefits of non-award arrangements, some retailers (particularly smaller ones) will prefer to have pay and conditions for their employees determined by the award. This may be, for example, because they prefer the certainty provided by the award or because the costs of negotiating additional flexibility through an enterprise agreement outweigh the potential benefits.

The potential benefits of enterprise bargaining depend on the extent to which the provisions of the award inhibit changes which management believe would enhance and encourage productivity and/or profitability. In terms of workplace flexibility, in this inquiry the major criticisms directed at the modern retail award relate to flexibility of hours, excessive penalty rates and minimum duration shifts for casuals. The first two concerns were discussed above in relation to the impact on labour costs of award modernisation.

#### *Minimum duration shifts for casuals*

The General Retail Industry Award 2010 states that the 'minimum daily engagement of a casual is three hours' (Clause 13.4). Similar provisions apply in other modern retail awards such as the Pharmacy Industry Award 2010 (PIA).

The three hour minimum engagement period was also the most common across pre-modern retail awards. The main exceptions in general awards covering retail/shop employees were a two hour minimum in Victoria and a four hour minimum applying in Tasmania. However, in some pre-modern retail awards in other jurisdictions minimum shift provisions of less than three hours applied in certain

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circumstances, for example, for juniors or at particular times. The Pharmacy Guild of Australia advised that ‘the capacity for a shorter than three hour shift for part time and casual employees was an existing industry standard in a number of relevant awards that are now superseded by the PIA’ (sub. DR181, p. 5). The Commission also understands that individual agreements with preferred hours clauses also provided some retailers with further flexibility in relation to minimum engagements.

The minimum engagement period does not preclude shorter periods of work, but an employer must provide payment for the minimum period if an employee is engaged. The rationale behind this requirement is that it is seen as unfair to expect workers to travel to and from a job for a shift of shorter duration. The ACTU consider that minimum engagement periods are important protections:

... ensuring that workers can have reasonable certainty and predictability of working time and incomes. This is particularly important for those who rely on paid care for dependents or who have long and costly journeys to and from work. (ACTU, sub. 100, p. 3)

Without minimum shift rules, employees could spend \$10 travelling to work, only to be told when they arrived that trade is slow and they are not wanted. In this case, their net wage, after transport costs, is negative. They could also be asked to ‘wait around’ and see if trade picks up; during this time they are in limbo, neither at work nor able to relax with friends or family. In both cases, this represents a shift of market risk (the risk of slow trade) from employers to workers — with no compensation or risk premium for the workers. Moreover, abolishing minimum shift provisions would discriminate against workers who could not afford to take short shifts (for example, those with significant travel times or costs to/from work).

In particular, there is a risk that employers would reduce the hours of day workers, and replace them with lower-wage workers. (ACTU, sub. DR180, pp. 22-23)

The ACTU did, however, acknowledge that short shifts do suit some workers:

Some people clearly who live next door to their workplace would be happy, perhaps to do a half hour shift and then go back home. (trans., p. 53)

The retail industry relies heavily on casual employment. This is related to the industry’s need for the flexibility to meet variable customer demand (for example, at different times of the day, the week or at particular times of the year). For employees, casual employment is attractive to those who wish to balance work and non-work commitments such as family, study or other jobs. For example, many students would be willing to accept work in retail before school (for instance, delivering papers) or in the hours between the end of school and close of business. Such shifts, where they had been facilitated under pre-modern awards, were often two hours or less in duration and benefited both employers and the students.

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Individual flexibility arrangements should, in principle, provide employers and employees with the flexibility required to implement mutually agreeable minimum engagement periods, but the Commission did not receive evidence that this is happening in practice.

A number of participants support a reduction in the number of hours specified as the minimum daily engagement period, for example:

Business SA supports a reduction in the minimum hours that retailers are able to employ workers from three hours to one and a half hours. This will improve flexibility for retailers and provide income for students and other part-time workers. (sub. DR174, p. 4)

Regulations that restrict [flexibility], such as minimum shift requirements or rising casual penalty rate loadings, act as a barrier to employment for some potential employees and restrict the flexible offerings retailers can make. (ANRA, sub. 91, p. 35)

The Guild strongly supports the need within the PIA and other retail awards for the facilitative capacity for employers and employees to agree to a minimum shift that is less than 3 hours. (The Pharmacy Guild of Australia, sub. DR181, p. 5)

The Australian Newsagents' Federation view the three hour minimum engagement clause in the General Retail Industry Award as having a particularly detrimental impact on newsagents (box 11.8).

### **Box 11.8 Impact of shift duration requirements on newsagents**

As employers who rely heavily on casual labour this has hit newsagents in at least two ways:

- Home delivery services have very tight margins and a variety of delivery times constraints attached to them by publishers. ... Despite this newsagents are being forced to employ personnel delivering papers for at least three hours in the mornings, often when they are needed for only one or two hours.
- After school hours. Students have long been associated with newsagents. However the three hour minimum employment period now means that newsagents who employ students, who would typically work a 4 pm till close (5:30 or 6 pm) shift, are faced with the dilemma of either paying for an additional non productive "free" hour or ceasing employing the student at all. This situation applies to a range of employees who require flexible working hours. Equally employing paper boys and girls on weekends has been significantly impacted by these changes.

*Consider the case of "Nick". For three years he has worked three nights a week, after school, for between an hour and a half and two hours. The newsagency was on the way home. He was happy with the work and the award wage he was paid. Now, under the new provisions, he will have to be let go since he cannot be given the minimum hours as the business closes at 6pm and he cannot get there before 4:15pm.*

Source: Australian Newsagents' Federation (sub. 99, pp. 18, 31-32).

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Currently, the relevant award covering post office staff — the Postal Services Industry Award — does not specify a minimum duration shift. The Post Office Agents Association of Australia told the Commission that maintaining existing flexibility is important as it benefits both the employer (licensee) and employees:

In the LPO [Licensed Post Office] sector there is a need for workplace flexibility. In some LPOs, for example, staff may be needed for only one or two hours in order to meet mail service standards. This flexibility must be protected. (Post Office Agents Association of Australia, sub. 127, p. 3)

... I'm not aware of one complaint from any casual staff member who has been asked to come in for one or two hours because it's usually regular work ... they might have dropped the kids off at school ... and they sort for an hour or two in the morning at the local post office.

Licensed post offices typically employ local people where there is minimum travelling involved and inconvenience. There's usually an amicable relationship between the licensee and the employees. (trans., pp. 128-129)

In 2010, a number of applications were made to FWA seeking a reduction to the minimum engagement for casual employees under the award, but these were unsuccessful. In June 2011, in response to a further application from the NRA, FWA decided the General Retail Industry Award should be varied, *for full time secondary school students only*. The decision reduces the minimum engagement period in the award for these students to one hour and thirty minutes where all of the following circumstances apply:

- the employee is engaged to work between the hours of 3.00 pm and 6.30 pm on a day which they are required to attend school
- the employee agrees to work, and a parent or guardian of the employee agrees to allow the employee to work, a shorter period than 3 hours
- employment for a longer period than the period of the engagement is not possible either because of the operational requirements of the employer or the unavailability of the employee.

An appeal against the decision by the SDA was dismissed by FWA. SDA have subsequently appealed to the Federal Court.

The Commission recognises that there are many important considerations to balance in determining optimal award provisions in relation to shift duration. While the recent FWA decision was welcomed by retail industry employer groups and, if upheld, will benefit many students seeking to work after school, the Commission notes the prescriptive minimum hours requirements in the award remain unchanged with respect to all other casual employees and indeed in relation to students working before school (for example delivering newspapers) or otherwise not meeting the

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strict and limited circumstances set out in the decision. This continues to be a constraint on employer flexibility and there is a risk that the restriction will have a perverse effect on many of the casual employees it is seeking to protect.

The differential treatment of secondary students and all other casuals that would be introduced into the award also potentially leads to inefficiencies by distorting employer decisions about staff engagement. It may, for example, create an incentive for retailers to engage students where they might have otherwise preferred to engage a more mature or experienced adult worker.

### **Flexibility in retail agreements**

The specific nature of enterprise agreements and the type of flexibility they encompass vary, depending on the characteristics of the firms and management attitudes and objectives.

Using information from DEEWR's Workplace Agreements Database, the Commission compared the incidence, in retail industry enterprise agreements, of different types of provisions — considered to have some nexus with productivity — relative to the average incidence of those provisions in agreements across all industries. Table 11.6 is based on an analysis of just over 2000 retail agreements, covering just under 400 000 employees, current at 31 December 2010.

A more detailed table reporting the relative incidence of a wider range of flexibility/productivity-related provisions, based on agreements made in 1997, 2000, 2005 and 2010, is included in appendix D. The table in the appendix also includes a brief description of each type of provision. The number of agreements and employees covered in each of the periods was provided in table 11.2.

A major focus of the enterprise agreements in the retail industry has been to increase employers' ability to tailor employee hours to match variable levels of demand, including greater flexibility in engagement (casual, part-time, job-share etc.), starting and finishing times, and in the distinction between ordinary hours and hours which attract penalty rates. There has also been a significant focus on the inclusion of training provisions and various family friendly provisions, such as carer's leave and unpaid family leave. The SDA argued that retail agreements include many productivity enhancing measures, including:

... casuals working up to full time hours without penalty, no proportions between full time, part time or casuals, roster changes by management, emergency roster changes, rosters changing with mutual agreement, part time hours being able to be reduced in difficult trading times, time off in lieu ('TOIL') ... (sub. DR183, p. 17)

**Table 11.6 Incidence in enterprise agreements of key productivity-related provisions: retail and all industries, at 31 December 2010<sup>a</sup>**

<i>Provision</i>	<i>Retail</i>		<i>All industries</i>	
	<i>% of agreements</i>	<i>% of employees</i>	<i>% of agreements</i>	<i>% of employees</i>
Competency-based wage movements (employees are automatically re-classified upon attainment of specified competencies)	2.8	1.7	5.3	8.4
Provides details of quantifiable KPIs	0.6	0.5	3.3	4.2
Performance pay/productivity-related bonuses	4.0	2.3	7.4	13.2
Contains a specific clause outlining a commitment to raising productivity <sup>b</sup>	16.8	3.2	38.1	25.1
Flexible working hours <sup>c</sup>	73.9	94.1	71.9	83.5
Flexible engagement <sup>d</sup>	98.6	99.6	94.9	97.8
Provisions allowing casual employees to work up to full time hours	12.8	47.3	6.3	14.1
Conversion of casual engagement to permanent engagement after a defined period	5.8	26.8	9.2	22.4
Training provisions, including provisions for general employees, apprentices and formal trainees	85.1	95.8	83.8	86.8
Training provisions for general staff	54.1	56.3	67.1	70.7
Training provisions for apprentices and formal trainees	76.7	90.0	60.4	65.6
Paid parental leave, return to work on a part time basis after parental leave, or a right to request flexibility for caring purposes greater than the provisions of the national employment standards	16.7	52.3	20.2	63.4

<sup>a</sup> Unless otherwise specified, figures are based on agreements current at 31 December 2010. <sup>b</sup> This data is designed to capture any reference of commitment to productivity enhancement in an enterprise agreement. The collection of this data only commenced from 1 January 2010. Figures are based on 401 retail agreements approved by Fair Work Australia in 2010. It does not include data for five of the six largest retail agreements current at 31 December 2010, because those agreements were approved before 1 January 2010. The low employee coverage figure compared to the level of agreements indicates that this commitment to raising productivity provision is more common in agreements covering smaller workplaces. <sup>c</sup> Includes 'hours may be negotiated', 'hours determined by agreement with majority of employees', 'management may alter hours', 'management may alter hours after consultation with employees' and 'make-up time'. <sup>d</sup> Includes casual, part-time, job-share, multi-hire and temporary employment data.

Source: DEEWR Workplace Agreements Database.

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In relation to some types of provisions, it is clear from the Commission's analysis that the retail industry has a similar or higher than average take-up rate compared to all industries. Examples of provisions where the incidence in retail agreements is significantly higher than for all industries, include: negotiated hours of work (75.6 per cent of retail agreements had such a provision in 2010 compared to 43.1 per cent for all industries); and management discretion to alter, without consultation, the hours an employee must work (retail 71.3 per cent compared to 31.4 per cent for all industries). For these two provisions and several others, the take-up rate in more recent agreements is also substantially higher than in those negotiated in earlier periods — for negotiated hours of work, increasing from an (unweighted) average of less than 10 per cent for the earlier years and for management discretion to alter, hours, increasing from an (unweighted) average of less than 5 per cent for the earlier years (appendix D).

However, for many of the provisions the take-up rate is very low. For instance, the take-up rate in new retail agreements approved in 2010 was 10 per cent or less for over 40 per cent of the provisions (for which data were available). Further, for many of these provisions and others (in total more than half the provisions) the incidence was lower in retail agreements than the all industries' average. For several provisions with perhaps the strongest nexus with productivity, the retail industry's take-up rate was particularly poor. This includes, for example, those provisions related to performance pay/productivity-related bonuses, commitment to raising productivity, work organisation/performance indicators and quantifiable key performance indicators. The relative take-up of provisions across industries will, however, be influenced by the particular operating requirements of businesses and the characteristics of their workforces.

Only 4.0 per cent of retail enterprise agreements current at the end of December 2010 (covering just 2.3 per cent of employees) included performance-related wage provisions. Only Accommodation and Food Services (1.2 per cent), Health Care and Social Assistance (2.6 per cent) and Agriculture, Forestry and Fishing (2.8 per cent) had a lower proportion of agreements containing such clauses. Amongst other industries, those with the highest incidence of performance-related wage clauses were Information, Media and Telecommunications (35.5 per cent), Mining (25.5 per cent) and Electricity, Gas, Water and Waste Services (22.6 per cent) (DEEWR Workplace Agreements Database).

The Commission recognises that the inclusion in agreements of certain types of provisions will not necessarily have efficiency benefits or net benefits overall for a retail business and its employees — that will depend on the particular design and operation of individual clauses. Further, some provisions may be more or less relevant (or feasible) for some sectors than others.

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The Commission considers that the DEEWR Workplace Agreements Database is broad and reasonably comprehensive in its coverage of productivity-related provisions and flexibilities in agreements. Nevertheless, the analysis may underestimate the true incidence of flexibility and productivity enhancing provisions in retail workplaces, to the extent that either:

- some retail workplace practices that facilitate flexibility are not actually included in agreements (SDA, sub. DR183)
- some provisions in agreements that it could be argued promote flexibility are not included amongst the provisions provided to the Commission.

That said, overall, the analysis suggests that many retail enterprises that entered into agreements did not take full advantage of the opportunity to adopt flexibility and productivity enhancing provisions. In particular, there would appear to be further scope for adoption of improved consultative arrangements and performance-related remuneration (appendix D). It was noted earlier in the chapter that the low take-up of performance-related remuneration could have impacted on Australian retail's productivity performance relative to some other countries where incentive and commission-based pay is more widespread.

### **Government promotion of workplace flexibility and productivity**

While the Australian Government has for several years promoted the benefits of workplace flexibility, there appears to have been greater emphasis in practice on strategies for developing family-friendly workplaces and raising workforce participation, rather than productivity.

In 2006, the (then) Department of Employment and Workplace Relations launched a *Flexibility Works* website as part of a *Retail Industry Project*. The project was one of several industry projects and complemented the Government's welfare reform policies by increasing opportunities for parents, mature aged workers, people with disabilities and the long term unemployed to gain employment that suited their needs and to balance paid work with caring responsibilities. The website, which has not been continued, included case studies and practical examples of how businesses could introduce flexible work practices.

More recently, the Fair Work Ombudsman has published a suite of Best Practice Guides, including *Work and Family*, *Consultation and Cooperation in the Workplace* and *Improving Workplace Productivity in Bargaining*. Although the latter guide has a focus on improving productivity, it mainly concentrates on best practice bargaining processes, rather than best practice provisions. The *Fresh Ideas for Work and Family Grants Program* administered by DEEWR provided funding

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to small businesses to implement, or improve existing, family-friendly work arrangements. While no further funding is available under the program, the DEEWR website continues to provide information on the advantages of family-friendly and flexible work arrangements, with some examples and case studies.

The implementation of family-friendly workplace flexibility initiatives clearly has the potential to benefit employers as well as employees and may enhance productivity through improving job satisfaction, morale, commitment, reduced sick leave, increased employee retention and lower training costs. In retail, the retention of staff with experience and well developed product knowledge can potentially lead to improved sales performance.

However, there appears to have been less focus in the Government's promotion of flexible workplace arrangements on best practice enterprise agreement provisions that have a more direct link with workplace productivity through increasing flexibility for employers or, for example, the adoption of innovative provisions in agreements that more directly encourage improved customer service and sales performance.

The Government has, however, consistently highlighted the importance of productivity growth as a driver of improvements in community wellbeing. The recent comments of the Secretary to the Treasury, Dr Martin Parkinson, reflect this emphasis on productivity:

Living standards are ultimately about productivity — how much individuals, businesses and governments produce for each unit of labour and capital. In the long run, productivity growth — producing more from the same inputs — is the only sustainable way for future generations to enjoy higher living standards. ...

We need to continue with reforms that increase the flexibility of the economy and its productive capacity in order that people and business are able to embrace change, adapt and innovate. (Parkinson 2011, pp. 11-12, 23)

In the 2011-12 Budget, the Government announced Building Australia's Future Workforce, which includes measures to establish:

- a new National Workforce and Productivity Agency, with initiatives to improve productivity, management innovation and skills utilisation in Australian workplaces; and
- a Productivity Education and Training Fund (\$20 million over two years), to assist union representatives and employers to achieve better productivity outcomes through enterprise bargaining under the Fair Work Act. (Australian Government 2011a)

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In the Government's ongoing efforts to assist employers, unions and employees to achieve productivity improvements, there should be a focus on maximising the benefits of individual flexibility arrangements as well as enterprise bargaining. There should be a particular emphasis on highlighting Australian and overseas retail industry best practices that could improve workplace productivity in Australian retail businesses, including those operating online.

## **Closing the productivity gap**

There was very little comment in submissions regarding specific strategies employers could adopt to improve workplace productivity or the particular lessons to be learnt from overseas best practices. However, traditional workplace relations matters relating to pay and conditions of employment are amongst many factors influencing retail industry productivity. Several submissions emphasised, in general terms, the importance of focusing on staff training/skills development (chapter 12), management practices, technology and process innovation and in particular customer service, as key drivers of productivity (see for example, SDA sub. 18, ACTU, sub. 100 and United Voice, sub. DR197). And, as has been discussed throughout this report, a supportive regulatory environment is also critical if strong and sustained productivity growth is to be achieved.

One participant, Mr Kelvin Morton, provided the Commission with personal insights based on his experience working in both Australia and the United States (with several leading companies, including Walmart.com and Safeway Stores). He has been able to compare the attitudes, strategies and performance of Australian retailers (in particular online retailers) with those he observed in the United States.

When I recently did some consulting work for a major Australian retailer, I found their systems and processes and general mindset to be approx. 5 years behind the work I was doing in the US — 5 years ago. No longer are they a few years behind, they are now entering decades. Worse still, is that they seem to have no strategically significant plan to try and close the gap.

Australian retailers have comprehensively failed to embrace online shopping as a means of servicing their customers. They are not positioned to develop meaningful relationships with customers which, when leveraged properly, can result in significant sales uplift and a greatly reduced operational spend....

They have failed to take advantage of technological capabilities and opportunities the internet offers them, deepening the relationship with customers, personalization of communication to customers, effectively moving from being a product centric organization, to a customer centric one. Placing their customer at the heart of all they do. They have maintained such a narrow, myopic view of trying to find new ways of gouging a shrinking customer base for more profits, that they have neglected their corporate responsibilities and squandered their organizational future. They have missed

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out on opening up their businesses to new markets in other countries - generating bigger revenues and returning larger shareholder returns. (Kelvin Morton, sub. DR131, pp. 1-5)

Although this is the perspective of just one individual, the observations do support the Commission's general impression that there is considerable scope for Australian retailers to be more innovative and find operational efficiencies that will enable them to generate greater output from a given level of labour and other inputs.

The pursuit of international best practice productivity and service levels will require improvements on many fronts. These include: better customer and after-sales service; superior logistics and management of working capital; greater automation; better management and leadership; and a multi-skilled and flexible workforce prepared to lead and facilitate innovative means of delivering value for customers, in some cases with better staff and management alignment in these tasks through incentives or commissions.

In a recent submission to the House of Representatives (PC 2009d), the Commission noted that improving productivity at a firm level involves a number of inter-related components which can be summarised under the headings of:

- incentives — the external pressures and disciplines on organisations to perform well; the most critical incentive usually being competition. Arguably historically, the retail industry in Australia has experienced a relatively benign competitive environment compared to that in other countries which may have reduced incentives for retailers to see productivity improvements as a priority. The growth of online retailing is clearly changing this environment
- flexibility — the ability to make changes to respond effectively to market pressures. Here workplace regulations, planning and zoning and trading hours regulations are important factors
- capabilities — the human and knowledge capital, as well as infrastructure and institutions, that are needed to make necessary changes. This importantly includes the quality of leadership and management in an organisation. The retail industry has invested considerable capital over the past two decades, but has lagged in recent years in raising its levels of multifactor productivity. To do so will require more innovative use of the combination of capital and labour, to develop new and better ways of delivering the products and services that consumers want.

All three components influence the motivation and ability of organisations to innovate and adopt improvements. Government policies have an important role to play in helping, or at least not hindering, firms to address most of these issues.

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## **Other obstacles to achieving workplace flexibility under the FW Act**

In addition to the concerns about IFAs that were noted above, employer groups and commentators more generally have identified various aspects of the FW Act that are making it more difficult for employers and employees to achieve workplace flexibility (see, for example, Ridout 2011 and Sloan 2010). The main concerns raised in this inquiry relate to changes to unfair dismissal laws, the operation of the ‘better off overall’ test and the business transfer provisions of the Act.

### *Unfair dismissal laws*

The Fair Work System includes a new ‘fair dismissal’ system which has operated since 1 July 2009. The Government established the new laws because it considered that some aspects of the old system did not provide ‘good employees’ with adequate protection from dismissal.

Under Work Choices, employees in businesses with up to 100 workers could be dismissed for any reason without any right to challenge the dismissal as being harsh, unjust or unreasonable. For other employees, the employer had only to demonstrate the dismissal was for ‘operational reasons’ and there would be no right of challenge or redress.

The removal of these rights resulted in clear hardship for many, and in real feelings of insecurity when workers realised they could be dismissed at any time for no reason. (DEEWR 2010b, p. 24)

The Fair Work Act applies the unfair dismissal provisions to all organisations irrespective of the number of employees. However, businesses with fewer than 15 employees are covered by some special arrangements, including:

- a minimum employment period of 12 months (double the six months applying to larger businesses) before employees qualify to make a claim for unfair dismissal
- a Small Business Fair Dismissal Code designed to assist small employers by setting out a procedural checklist and evidentiary requirements that, if followed by employers, will ensure a dismissal is not unfair.

Casuals employed on an irregular basis are not eligible to make a claim for unfair dismissal, however, those engaged on a regular and systematic basis who have a reasonable expectation that their employment would continue on that basis, can make a claim. Employees whose remuneration is more than an indexed high income threshold (\$113 800 at 1 July 2010) are excluded from making a claim, unless a modern award or enterprise agreement covers or applies to their employment (DEEWR 2010b).

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The ACCI submission raised a number of issues in relation to the unfair dismissal laws (box 11.9).

**Box 11.9 ACCI concerns about unfair dismissal laws**

... the unfair dismissal laws under the Fair Work system also have the effect of limiting the capacity of a firm to terminate the employment of an employee, where an employee has a right to challenge that dismissal on procedural grounds, despite the employer having a valid reason to terminate the employee. A firm who wishes to restructure and make redundancies may also be required to reinstate the worker if they do not follow certain procedures under the Fair Work laws. A right to challenge redundancies on procedural grounds bears no relationship to the actual operational requirements or needs of the firm to restructure, but penalises employers for failing to comply with procedural rules (ie. form is elevated above substance). Other requirements force a service industry business within a large corporate group to consider alternative positions not only within its own business, but across hundreds of other disparate business operations which imposes significant red-tape and challenges on even the most well-resourced companies....

Smaller service industry employers may benefit from ... [the Small Business Fair Dismissal Code] ... depending on whether they can successfully defend their reliance on the Code. In any event, reliance on the Code does not prevent a claim being brought by an employee with a small business employer having the onus to defend their actions and reliance on the Code before Fair Work Australia. ...

A growing number of cases [unfair dismissal applications] illustrate that employers are being penalised for dismissing an employee despite having a valid reason for doing so. For example, employers have been successfully sued by employees in circumstances where serious misconduct has occurred (i.e. not following strictly OH&S protocols, or trying to protect other employees from sexual harassment and stalking) or where redundancies were overturned because procedural requirements were not followed strictly.

Despite assurances to business that the new Fair Work laws would “remove ‘go away money’ from the unfair dismissal system”, anecdotal and independent research suggests that this is not occurring. At recent Senate Education, Employment and Workplace Relations Committee, FWA officials indicated that in the two months from July 1, 2010 (when official records started to be kept of unfair dismissal settlements), 979 of conciliated unfair dismissal claims — or 75 per cent of the total — involved a payment to an employee, with the most common ranging from \$2000-to-\$4000, and 1% involving sums of between \$30 000 and \$40 000. Furthermore, a recent report commissioned for Fair Work Australia indicated that 76 per cent of employer participants surveyed wanted to avoid the “cost, time, inconvenience or stress of further legal proceedings” by settling the matter ‘out of court’, rather than defending the matter in further arbitral proceedings.

*Source: ACCI (sub. DR196, pp. 25-27).*

The ACCI also has concerns about the new general employment protection laws (Part 3-1 of the FW Act) and their potential impact upon the ability of employers to manage their workforce:

... the new Fair Work laws ‘general protections’ regime significantly extends the capacity for employees and unions to litigate in the federal courts, including obtaining

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injunctions stopping legitimate business decisions from occurring (i.e. redundancies and restructuring). Employers who wish to terminate or alter the working arrangements may be liable under these laws if the employee alleges that action was taken as a result of a “workplace right”. (ACCI, sub. DR196, p. 35)

Another specific concern relates to the definition of a small business. Under the FW Act, effective from 1 January 2011, a national system employer ‘is a *small business employer* at a particular time if the employer employs fewer than 15 employees at that time’ (s. 23). This appears to have contributed to some perverse outcomes, as Eltham Valley Pantry submitted:

A further disincentive to hire young casual workers is the changed definition of a small business from 15 FTE employees (a fair and specific definition of a small business) to the ridiculous ‘head count of 15’ ...

I previously had a number of job sharing arrangements with young people who worked 6 hours each alternative Sunday and could cover for each other. In order to remain under the ‘headcount of 15’ I have now halved the number of kids working under these arrangements by now requiring them to work every Sunday instead of alternative Sundays. (sub. 9, pp. 7-8)

Employers point out that the number of claims for unfair dismissal has risen sharply since the FW Act became law and the number of unfair dismissal claims may rise further as employees become more familiar with the new provisions. In 2009-10, there were over 11 000 applications for unfair dismissal, compared with less than 7000 the previous year.<sup>10</sup> There have been calls for more small businesses to be exempted from the FW Act and/or for the coverage of the Small Business Fair Dismissal Code to be extended.

The ACTU, on the other hand, consider that the current unfair dismissal laws are moderate, not onerous, that employers who act fairly have nothing to fear from the rules and that ‘it is hard to believe that [they] ... could impose any real constraint on the decision of an employer to hire or fire’ (sub. DR180, pp. 19-20). The ACTU also presented evidence and analysis in its submission to argue:

- a very small proportion of dismissals result in claims against employers — while it is acknowledged that the number of claims has increased, in the context of the substantial increase in coverage of unfair dismissal laws the level of claims remains low
- of the claims dealt with by Fair Work Australia in 2009-10, 99 per cent were settled before hearing — of those settled in official conciliation, 25 per cent were settled without monetary payment from the employer; 21 per cent for less than \$2000; and 23 per cent for less than \$4000

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<sup>10</sup> FWA 2010 and AIRC 2009.

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- of the 87 claims that were arbitrated, the employer won in 35 cases. In 15 of those cases, reinstatement was ordered and in the other 20 cases compensation was awarded — less than \$4000 in 29 per cent of cases, less than \$13 000 in 65 per cent of cases and the maximum amount of compensation (6 months' wages) was awarded in fewer than 2 per cent of cases
  - 'Australia has some of the weakest unfair dismissal laws of all the countries that have ratified (or otherwise observe) the ILO's *Convention on Termination of Employment*, including most European countries'
  - levels of compensation for unfair dismissal are very low by international standards. (sub. DR180, pp. 18-20).

The ACTU also claim that unfair dismissal laws can boost productivity 'by enhancing employee commitment to the business' (sub. DR180, p. 2). However, an argument can also be made that such laws, if tipped too far in favour of protecting workers, can lead to underperformance and reduced productivity. More importantly, fear of an unfair dismissal complaint can potentially make employers more cautious about taking on additional staff and this can impact particularly on the lowest skilled, least experienced and those at most risk of long-term unemployment. The OECD has made the following observations about the new unfair dismissal provisions:

Care needs to be taken that the restoration of unfair dismissal protection at small and medium-size enterprises does not impair labour market flexibility ....

The new system of dealing with unfair dismissal claims should ... be closely monitored to make sure that the administrative costs faced by the firms, especially smaller ones, are not so high as to jeopardize productivity growth and redeployment of labour ... (OECD 2010, p. 135)

Unfair dismissal provisions must balance, on the one hand, the need to ensure reasonable flexibility for employers to hire and fire and, on the other hand, the need to ensure fairness for employees. The Commission cannot make a judgement, based on the limited evidence it has received and given the retail-specific focus of this inquiry, as to whether the current laws are the most appropriate. It is important that the Government carefully monitors the operation of the new system to establish whether outcomes are consistent with policy objectives and that any costs imposed on business are justified.

The *Fair Work (Transitional Provisions and Consequential Amendments) Act 2009* requires the general manager of FWA to prepare a report about the first three years of the operation of the unfair dismissal system, that is from 1 July 2009 to 30 June 2012. The report, where possible, is to include information about the number of applicants awarded compensation by FWA and the amounts of that compensation,

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as well as information on the compensation paid or other remedies provided for the matters that have settled. The report is to be given to the Minister no later than six months after 30 June 2012.

*'Better off overall' test*

Under the FW Act, agreements must meet the 'better off overall' test, which states:

... Each award covered employee, and each prospective award covered employee, for the agreement would be better off overall if the agreement applied to the employee than if the relevant modern award applied to the employee. (Section 193(1), *Fair Work Act 2009*)

This test is similar to the no-disadvantage test that was introduced on 28 March 2008 when the *Workplace Relations Amendment (Transition to Forward with Fairness) Act 2008* commenced operation, in that agreements will not be approved if any employee is disadvantaged compared with the award. In contrast, the earlier fairness test introduced in the 2007 'Stronger Safety Net' amendments to the Workplace Relations Act had a lower hurdle. For a collective agreement to pass the fairness test, the Workplace Authority Director had to be satisfied that, on balance, the collective agreement provided fair compensation in its overall effect on the employees, whose employment was subject to the collective agreement, in lieu of protected award conditions (DEEWR 2010a).

Employers have stated that the requirement to satisfy the 'better off overall' test is increasing the cost of negotiating more flexible work arrangements, in particular flexible working hours. Woolworths, for example, submitted:

Whilst retailers can negotiate flexibility to open stores during this time [outside the period Monday to Friday between 9am and 5pm] (as Woolworths has done through agreements such as Woolworths National Supermarket Agreement) there is a considerable cost in doing so. This is because retailers must effectively negotiate higher average wage rates and in most instances will still have to pay penalty rates for hours of work done outside these "standard" hours.

This is to pass the requirements of the BOOT [Better Off Overall Test]. (sub. 110, Appendix, p. 44)

It has also been stated that it is administratively costly to determine with any confidence whether an agreement will satisfy the better off overall test and that approval processes are complex. The better off overall requirement can make the negotiation of agreements less attractive to employers and employees can potentially miss out on the opportunity to support acceptable trade-offs of pay and conditions.

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Restaurant and Catering Australia commented:

... many employers now find that because of the complex approval process and little ability to genuinely offset award provisions there is no commercial incentive to implement an enterprise agreement compared to previous collective agreements including those implemented in Australia by the Keating Government in the 1990s. (sub. DR193, p. 9)

Similarly, the Shopping Centre Council of Australia considers 'it is difficult to see how greater enterprise-based arrangements can be encouraged, or will hold out much advantage for employers, while a 'better off overall' or 'no disadvantage' test applies.' It suggests that the better off overall test 'should be replaced with a 'fairness test' similar to that which applied initially under the previous Workplace Relations Act, before the adoption of the 'no-disadvantage test''. (sub. DR186, p. 13).

### *Business transfer provisions*

The submission by Woolworths (sub. 110) also identified the business transfer provisions of the FW Act (Part 2-8) as a constraint on flexibility. The ACCI commented briefly on 'inflexible transmission of business rules' (sub. DR196, p. 6).

The effect of the business transfer provisions is that enterprise agreements and certain modern awards and other instruments that covered employees of the old employer continue to cover those employees if they accept employment with the new employer.

According to Woolworths, this hinders the ability of retailers to harmonise labour and employment relationships and to flexibly move team members across business divisions. More specifically, Woolworths stated:

The effect of these provisions is that they inhibit the extent to which Australian retailers can increase their scope and capacity to achieve economies of scale through purchasing other businesses. This is because many of the synergies underpinning such acquisitions arrive from harmonising the employment arrangements between the target and acquiring business. Alternately, the associated entity provision, means that if an employee is transferred between businesses, in their new role their employment will still be governed [by] the industrial instrument from their previous role. This creates the situation where the two employees undertaking the same role will have different benefits (and potentially pay rates) where one employee's role is still governed by the industrial agreement from their previous role. From a retailer's perspective, this creates a number of operational and administrative difficulties as well as limiting the ability to provide employees with flexible work opportunities across the whole business (where there may be an incentive to avoid transferring staff between retail brands). (sub. 110, attach., pp. 45-46)

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The Commission notes that the circumstances in which a transfer of business occurs under the Part 2-8 provisions of the FW Act are broader than the previous ‘transmission of business provisions’ contained in the *Workplace Relations Act 1996*. Woolworths also pointed out that under the FW Act, the transferring instruments ‘apply until terminated or replaced (where previous legislative [provisions] provided that transferring instruments only applied to the new employer and the transferring employee for 12 months after a transmission of business)’ (sub. 110, attach., p. 45).

The ACTU considers that there is a ‘public interest’ in maintaining strong transfer of business rules, and the new rules are ‘entirely appropriate’. More specifically:

Without transfer of business rules, there would be nothing to stop an employer entering into a collective agreement with its workforce, and the next day selling the business to another firm (or even a subsidiary), with the loss of agreement conditions. Indeed, in the absence of transfer of business rules, workers would have little incentive to make collective agreements, knowing that they did not survive a business transfer. The result would be a serious erosion of trust and co-operation between the parties, leading to a withdrawal of employee effort and greater levels of industrial disputation. ...

These new rules mean that it is harder for employers to avoid their obligations under collective agreements. They also mean that firms looking to acquire other firms must honour collective agreements (at least until they reach their normal expiry date, at which point they can be renegotiated) in the same way that they must honour existing leases and mortgages entered into by the old business. (sub. DR180, pp. 20-21)

The objective of the business transfer provisions, as set out in the Act is, appropriately, ‘...to provide a balance between the protection of employees’ terms and conditions of employment ... and the interests of employers in running their enterprises efficiently; if there is a transfer of business ...’ (Clause 309).

Whether, in the application of the Act, the appropriate balance is being struck, is a question that requires further evidence based on the experience of employers and employees and a careful weighing of the costs and benefits. Such an analysis is not feasible in the context of this inquiry, but the Commission considers that the operation of the transfer of business provisions should be closely monitored by DEEWR. If there is evidence of more widespread employer concerns, a more detailed investigation should be undertaken.

## 11.7 Conclusion

The contribution of the Australian retail industry to the economy and broader community wellbeing relies on it becoming more responsive to consumer demand and more competitive in the face of international online retail competition and new

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international retailers establishing themselves in Australia. Workplace practices and the workplace regulations that underpin those practices, have an important role to play in increasing the productivity of the industry and ensuring the operational flexibility of retailers.

Various stakeholders have clearly different views regarding the operation of awards and workplace employment regulations. Unions highlight the relatively low levels of pay in the industry and argue that current awards and workplace relations regulation provide sufficient flexibility for employers. Retailers and employer groups, on the other hand, raised a number of concerns about the implications of awards and various Fair Work Act provisions for employment costs and operational flexibility.

Some retail employers consider that award provisions are unnecessarily constraining their flexibility to implement workplace arrangements that will enhance productivity and profitability. Their particular concerns include:

- increases in certain penalty rates in some jurisdictions, as a result of award modernisation, are impacting on the ability of some retailers to trade profitably at the times many consumers now prefer to shop
- minimum award wages that are high in Australia, by international comparison, are constraining the ability of employers to restructure employee remuneration in ways that could enhance productivity, for example, through greater use of performance-related commission or incentive payments
- award requirements that casuals be engaged for no less than three hours have also constrained workplace flexibility.

At the same time, the level of award reliance of the retail workforce, although declining, remains relatively high. This suggests that many retail employers and their employees have not used past and current workplace relations flexibility to examine how their workplace practices can be improved. Where workplace agreements have been struck, the Commission has found that many retail employers may not have taken full advantage of the opportunities to incorporate productivity-related provisions.

Chapter 3 provided evidence that the main driver of productivity growth in retail in Australia compared to the United States has been increasing capital intensification of the workplace. Improving how capital and labour work together — that is, improving workplace practices to improve productivity, competitiveness and customer satisfaction — appears to have been a secondary consideration. If the Australian retail industry is to become more competitive in the face of international online retail competition, it is critical that employers, employees and unions work

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constructively to implement productivity enhancing workplace arrangements. This includes those arrangements focused on operational and trading hours flexibility and improved customer service.

That said, participants have indicated that provisions in the FW Act governing the making and approval of enterprise agreements, in particular the ‘every worker must be better off overall’ test, are increasing the cost and complexity of negotiating enterprise agreements and making productivity improvements more difficult to achieve. At the same time, it is claimed that constraints on the negotiation and operation of individual flexibility arrangements has meant that they do not, in practice, offer the sort of flexibility promised.

More generally, the concerns raised by industry suggest there could be scope to improve the operation of workplace regulation to enhance flexibility and adaptability at the enterprise level. Any changes, however, have impacts beyond the retail industry and it is not appropriate in the context of this review for the Commission to recommend specific changes. Moreover, because the needs of employees (current and future) and those of employers must be carefully balanced and the impacts on the broader community considered, reform proposals in this area must be subjected to rigorous impact analysis.

The Commission notes that previous major reforms to workplace relations laws have not been the subject of adequate and transparent regulatory impact analysis. With respect to the draft Fair Work legislation, the Prime Minister granted an exceptional circumstances regulation impact statement (RIS) exemption at the decision-making stage. As a consequence, the Government committed to undertaking a post-implementation review within two years of the full implementation on 1 January 2010. That review is an opportunity to examine some of the issues raised with this inquiry about aspects of the operation of the FW Act. The review should be public, transparent, independent, seek input from all relevant stakeholders and require the same rigour as the RIS process.

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RECOMMENDATION 11.1

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

*The first review of modern awards by Fair Work Australia, scheduled for 2012, is a further opportunity to address concerns that relate specifically to the operation of relevant retail awards. This review should also provide adequate opportunity for input from all relevant stakeholders.*



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## 12 Employment, skills and training

### Key points

- After steady growth for over a decade, employment in retail has stabilised, falling marginally by 1900 or 0.2 per cent in the three years to 2010. By comparison employment in the economy grew by 6.3 per cent in the three year interval.
- Some sectors have experienced strong employment growth while others have contracted. Employment in department stores fell by 19 500 or 18.5 per cent in the fifteen years to February 2011 while over the same period employment in supermarkets and grocery stores grew by 75 700 or 36.7 per cent.
- The retail workforce is relatively youthful and unskilled, has a high proportion of women compared with other industries, and is characterised by part time and casual work.
- Job turnover in the industry is relatively high mainly due to its youthful profile. Job satisfaction among retail workers is rated lowest against pay and hours worked and highest against job security and access to flexible working arrangements.
- Retail employers appear to invest less in training — one quarter of persons employed in retail in 2009 had undertaken work-related training in the previous 12 months compared with just over one third of persons employed in all industries. However, this could be due to lower skill requirements for the industry.
- A sustained drop in skilled vacancies was recorded for retail occupations in the 18 months to July 2009 — vacancy levels have only partially recovered since.
- There do not appear to be widespread or substantial skill shortages in the industry. However, there is evidence of shortages of employees in niche occupations, particularly those with good IT skills who have knowledge of website interface technology as well as people with strategic knowledge of the online shopping industry.
- To the extent that retailers choose to compete on the services they offer rather than the price they charge, there will be greater need to develop a workforce with higher customer service skills and higher productivity. To achieve this, employers may need to invest more in training their employees, and in order to get an adequate return on this investment, they may need to retain their employees for longer than they generally do.

The nature of retailing is changing with the rise of online retailing and changing consumer tastes. Many retailers are looking to recast the nature of the services they

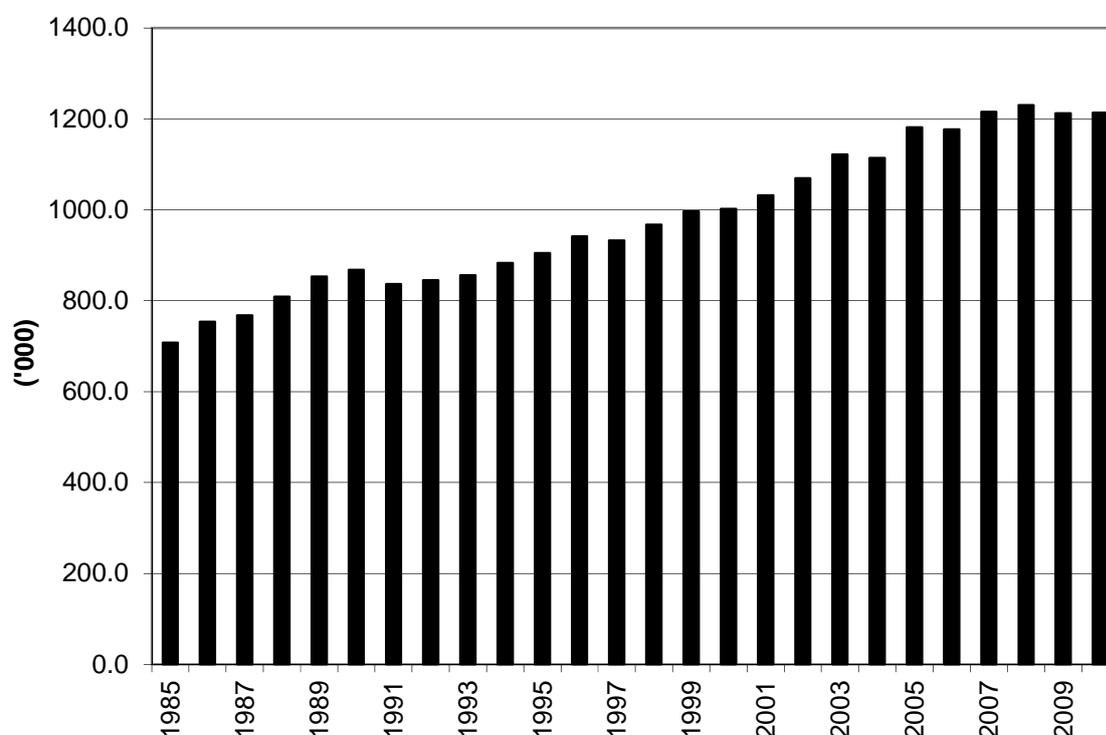
deliver and refashion store formats. This chapter analyses trends in employment growth in retail, characteristics of the retail workforce, the rate of supply of skilled workers, and any evidence of skill shortages, to ascertain whether the retail workforce is well positioned to meet these future trends. This chapter also outlines the differing projections for employment in the industry, particularly the estimated impact of online shopping, as a way of highlighting the differing views surrounding the future of the industry.

## 12.1 Employment

### Trends

The retail industry is the second highest employing industry in Australia, accounting for 10.8 per cent of the workforce in 2010. After steady growth between the early 1990s and 2005, employment in retail has stabilised, falling marginally by 1900 or 0.2 per cent between 2007 and 2010 (figure 12.1). Over the same interval employment in the economy grew by 6.3 per cent.

Figure 12.1 Employment levels in retail, 1985 to 2010<sup>a</sup>



<sup>a</sup> Includes all retail categories. Four quarter average seasonally adjusted data.

Source: ABS (*Labour Force Survey*, Cat. no. 6291.0.55.003).

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Employment in retail (excluding motor vehicles and fuel retailing) is concentrated in supermarket and grocery stores (25.1 per cent of employment in the industry in February 2011), as well as pharmaceutical and other store-based retailing (14.9 per cent), clothing, footwear and personal accessory retailing (13.0 per cent), specialised food retailing (9.8 per cent), department stores (7.7 per cent), hardware, building and garden supplies (7.0 per cent) and recreational goods retailing (6.8 per cent) (table 12.1).

ABS industry data by subdivision is available from 1996. Industry subdivisions with the largest shares of employment growth in retail in the fifteen year period from February 1996 to February 2011 were supermarket and grocery stores (24.6 per cent of total employment growth in the industry), clothing footwear and personal accessories (15.0 per cent), hardware, building and garden supplies (11.1 per cent) and specialised food retailing (10.9 per cent) (table 12.1). Department stores were the only sector to record a drop in employment over this period from 105 500 to 86 000 — a fall of 19 500 or 18.5 per cent. In contrast, employment in supermarkets and grocery stores has grown by 75 700 or 36.7 per cent.

Around 14 400 people were employed in non-store retailing in February 2011 — up from 2 400 fifteen years earlier. Non-store retailing includes ‘pure play’ retailers as well as a number of other non-store based retailing activities. The sector only accounted for 1.3 per cent of all retail employment in February 2011.<sup>1</sup>

As reported in Chapter 4, the ABS does not provide disaggregated data for employment in internet retailing. It is also unclear if employment data for non-store retailing includes the administrative, warehousing, transport and delivery personnel employed to support the online shopping process, as well as IT specialists and other staff required to set up and maintain online platforms. Some of these jobs would be contract-based and may be regarded as placements for employees of labour hire or employment agencies rather than staff of non-store retailing establishments.

Given these potential data deficiencies, it may be difficult to monitor trends in employment created by online shopping in the future, but it will be much easier to monitor job losses in store-based retailing. Employment projections for store-based retailing and non-store based retailing are discussed later in the chapter.

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<sup>1</sup> The ABS includes the following activities in non-store retailing: direct mail retailing; direct selling of books, cosmetics and other items; internet retailing; milk vending; mobile food retailing; and vending machine operations.

**Table 12.1 Composition of employment levels and growth by industry subdivision, February 1996 to February 2011<sup>a</sup>**

	<i>Employed total Feb 1996</i>	<i>Employed total Feb 2011</i>	<i>Change in Employment (Feb 1996 to Feb 2011)</i>	<i>Share of growth in retail employment (Feb 1996 to Feb 2011)</i>	<i>Share of total retail employment Feb 2011</i>
	'000	'000	'000	%	%
Supermarket & grocery stores	206.2	281.9	75.7	24.6	25.1
Specialised food retailing	76.7	110.2	33.5	10.9	9.8
Food retailing, nfd	na	6.8	6.8	2.2	0.6
<b>FOOD RETAILING</b>	<b>283.0</b>	<b>398.9</b>	<b>115.9</b>	<b>37.7</b>	<b>35.5</b>
Furniture, floor coverings & houseware	34.0	39.8	5.8	1.9	3.5
Electrical & electronic goods	41.7	74.7	33.0	10.7	6.6
Hardware, building & garden supplies	44.8	79.0	34.2	11.1	7.0
Recreational goods	56.1	76.0	19.9	6.5	6.8
Clothing, footwear & personal accessories	99.9	146.1	46.2	15.0	13.0
Department stores	105.5	86.0	-19.5	-6.3	7.7
Pharmaceutical & other stores	149.3	167.5	18.2	5.9	14.9
Other store based retailing, nfd	na	0.8	0.8	0.3	0.1
<b>OTHER STORE-BASED RETAILING</b>	<b>531.3</b>	<b>670.0</b>	<b>138.7</b>	<b>45.1</b>	<b>59.6</b>
<b>NON-STORE RETAILING<sup>b</sup></b>	<b>2.4</b>	<b>14.4</b>	<b>12.1</b>	<b>3.9</b>	<b>1.3</b>
Retail commission based buying & selling	na	0.2	0.2	0.1	0.02
<b>RETAIL TRADE NFD</b>	<b>na</b>	<b>40.6</b>	<b>Na</b>	<b>13.2</b>	<b>3.6</b>
<b>TOTAL</b>	<b>816.7</b>	<b>1124.0</b>	<b>307.3</b>	<b>100.0</b>	<b>100.0</b>

<sup>a</sup> Original data - excludes motor vehicles, fuel and motor vehicle parts and tyres. <sup>b</sup> Non-store retailing includes direct mail retailing; direct selling of books, cosmetics and other goods; internet retailing; milk vending; mobile food retailing (except takeaway food); and vending machine operation (except leasing). NFD is not further defined. na - this category was not available in Feb 1996.

Source: ABS (*Labour Force, Australia, Detailed, Quarterly*, Cat. no. 6291.0.55.003, Data cube E05\_Aug 94).

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The Direct Selling Association of Australia (DSAA) expressed concerns to the Commission about the quality of ABS data for employment in non-store based retail. The DSAA claim that a major restructure of the ABS definition of non-store based retailing and retail commission based buying and selling is required to recognise the number of people involved in direct marketing and selling (DSAA, sub. 95). ABS data show very small numbers of people involved in these activities (table 12.1).

Non-store based retail includes the workforce of ‘pure play’ retailers but disaggregated information for this group is not currently available. It would be useful given the growth of online retailing, to understand employment trends for the workforce of pure play retailers. In Chapter 4 the Commission recommends (Recommendation 4.1) that the ABS monitor trends in employment for both ‘pure play’ and multi-channel retail establishments.

### **Characteristics of the retail workforce**

The nature of the retail workforce, as distinct from the general workforce, can be better understood by analysing a number of characteristics such as age, gender, hours worked, educational attainment and conditions of employment.

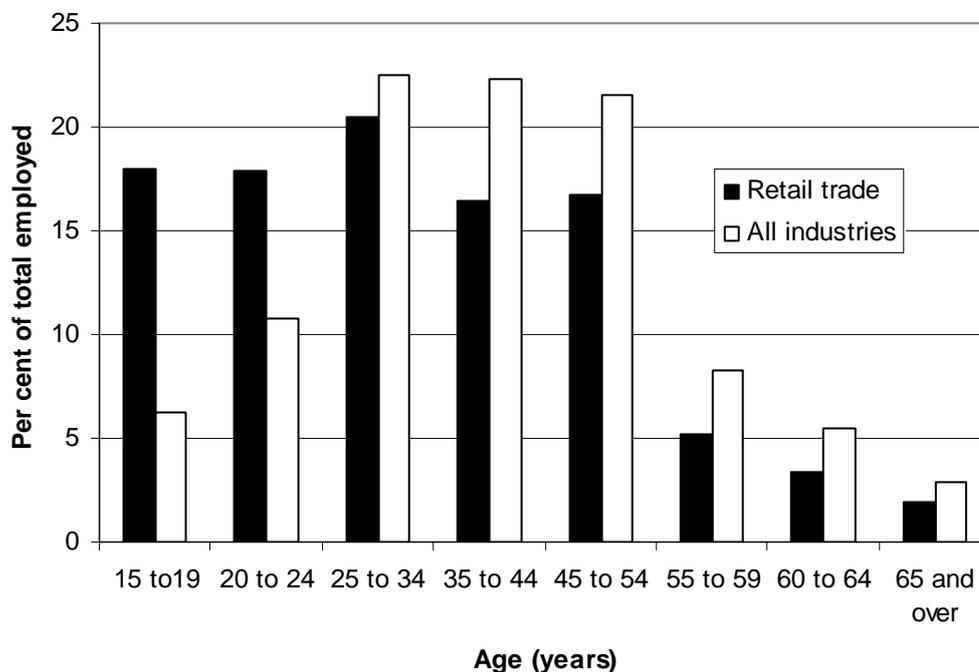
#### *Age*

The retail workforce has a relatively youthful profile — just under three quarters (72.8 per cent) are aged 45 years or less. By comparison 61.8 per cent of employed persons in all industries were aged 45 years or less. Further, 35.8 per cent of employed persons in retail are aged 15 to 24 years. By comparison 17.0 per cent of employed persons in all industries are in this age group (figure 12.2).

Many retail employees are young people who have a preference for working part time while completing full time education. ABS data show that people aged 15 to 24 years working part time account for just under a quarter (24.7 per cent) of all employment in retail while people in this age group working part time only account for 7.3 per cent of employment in all industries (ABS 2011e).

Despite its relatively youthful profile the share of mature aged employees (aged 45 years and over) in retail has increased from 22.0 per cent in February 1995 to 27.2 per cent in February 2011. Part of the reason for the growing share of mature age workers in the industry is the gradual ageing of the retail workforce — a characteristic shared among the workforce of all industries as the population ages.

**Figure 12.2 Distribution of employment by age, February 2011**



Source: ABS (*Labour Force, Australia, Detailed, Quarterly*, Cat. no. 6291.0.55.003, Data cube E05\_Aug 94).

Ageing of the workforce is likely to be a particular concern for the retail industry in the future as young workers aged 15 to 24 years make up such a large share of the workforce. Part of the attraction of employing younger casual workers for retail employers is the preference they have for part time hours and apparent willingness to sacrifice access to leave entitlements for higher hourly rates of pay. These characteristics complements employer needs to have a more flexible workforce. Younger workers are also less expensive to employ than older and more experienced workers. Junior employees receive a percentage of the adult minimum wage rate based upon their age up until they reach the age of 21 years. Separate minimum wages exist for trainees and apprentices.

In the future, retailers will be competing with other industries for a cohort of younger workers whose share of the workforce will be gradually declining. This may force employers to seek older employees to fulfil their labour needs.

The retail industry has a relatively high concentration of female employees (at 55.8 per cent of total employees) compared to the all industry average (of 45.2 per cent). The female share of total employment in retail has been little changed since February 1995 when it stood at 54.3 per cent (ABS 2011e).

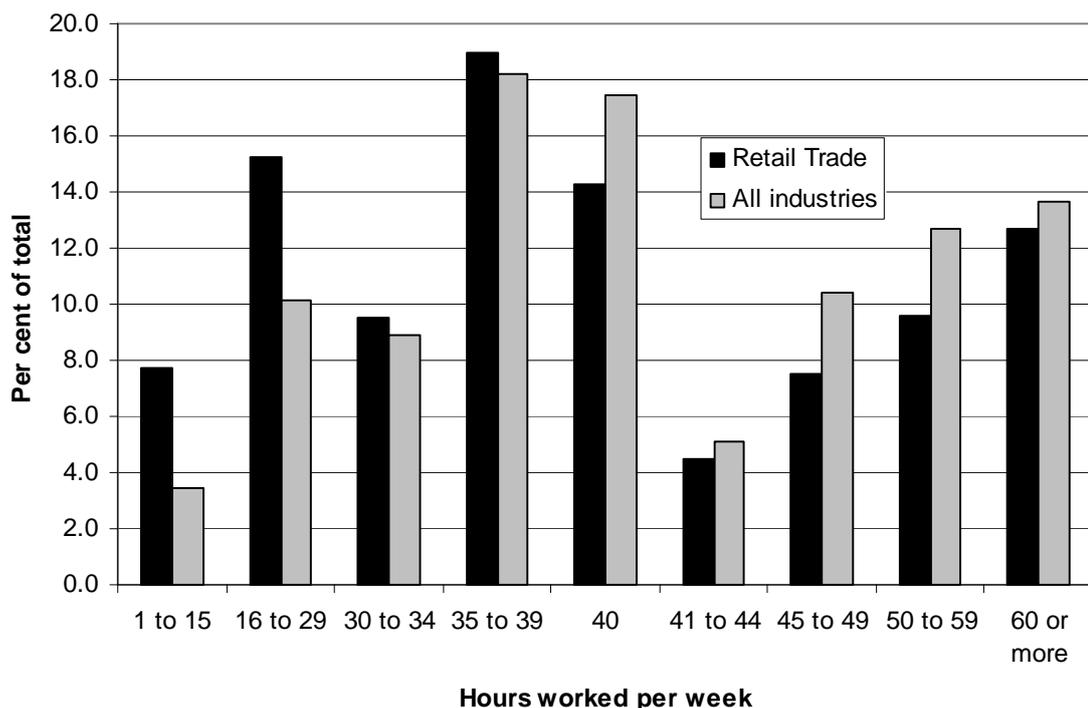
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### Hours worked

The distribution of hours worked in retail differs from the industry average with a relatively large proportion of employees working shorter hours — 23.0 per cent of employees in retail worked for 29 hours per week or less in May 2011 compared with 13.6 per cent for employees in all industries. Retail employees are much less likely to work longer hours with 29.8 per cent working 45 hours or more per week compared with the all industry average of 36.7 per cent (figure 12.3).

Consistent with a rising share of part time employment, average working hours per week of retail employees has fallen from 32.1 in February 1995 to 28.7 in February 2011. By comparison average working hours per week for employees in all industries has fallen from 36.1 to 34.2 in the same interval (ABS 2011e).

**Figure 12.3 Distribution of hours worked, May 2011**



Source: ABS (*Labour Force, Australia, Detailed, Quarterly*, Cat. no. 6291.0.55.003, Data cube E11\_May 01).

### Educational attainment

Employees in retail are relatively low skilled with lower average educational attainment than workers in other industries. For example, 58.7 per cent of workers in retail were without a post-school qualification in 2009, which compares to the all

industry average of 39.5 per cent. Around 20.7 per cent of employees in retail had a diploma or above (includes those with Bachelor degrees and higher) and 20.2 per cent had certificate qualifications. By comparison the industry average for workers with a diploma or above was 37.7 per cent, but a similar proportion of workers in all industries had certificate qualifications (at 21.6 per cent) (ABS 2010c). The major reasons for the relatively low average educational attainment in retail is the high proportion of young students who work in the industry who are yet to graduate and relatively low level of skills required to participate in the industry.

### *Conditions of employment*

A substantial proportion of employees in retail are casual employees who do not have access to leave entitlements. Casual employees in retail are paid a loading on their hourly rate of pay in lieu of leave entitlements. Around 40.3 per cent of employees in retail are employed on a casual basis which is well above the all industry average of 23.9 per cent.

Over a half (53.9 per cent) of retail workers are employed on a part time basis which compares with 30.2 per cent of employees in all industries (table 12.2).

**Table 12.2 Composition of employees by full time/part time and permanent/casual status, November 2010<sup>a</sup>**

	<i>Retail trade</i>	<i>All industries</i>	
	<i>Level</i>	<i>Share of total employment in retail</i>	<i>Share of total employment in all industries</i>
	'000	%	%
Permanent	646.3	59.7	76.1
Casual	436.7	40.3	23.9
ALL	1083.0	100.0	100.0
Full time	498.9	46.1	69.8
Part time	584.1	53.9	30.2
ALL	1083.0	100.0	100.0

<sup>a</sup> Permanent employees have access to leave entitlements while casual employees do not.

The ABS *Forms of Employment* survey shows a higher proportion of employees working part time in retail (at 53.9 per cent) compared with the part time share of total employment of 48.6 per cent from the ABS *Labour Force Survey*. Part of the difference is explained by the fact that the *Forms of Employment* survey only refers to employees, while employment data from the *Labour force Survey* includes owner managers of retail enterprises who would be much more likely to be working full time.

Source: ABS (*Forms of Employment*, Cat. no. 6359.0, November 2010).

While flexibility is highly sought after by retail employees, ABS data show that they may encounter more difficulties than workers in other industries in securing

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some of their preferences such as negotiating preferred start and finishing times. Approximately a third (34.5 per cent) had a say in their start and finish times which is below the all industry average of 41.5 per cent and below related industries such as wholesale trade (46.1 per cent). Exactly a third could choose to work extra hours in order to take time off, which compared with the industry average of 39.3 per cent. Despite these findings, Household Income and Labour Dynamics in Australia (HILDA) survey data show that retail workers tend to be only slightly less satisfied than workers in all industries with flexibility to balance work and non-work commitments.

Retail workers are also much more likely to experience variable earnings — a third of retail employees compared with a quarter of all employees. This is primarily due to the high incidence of casual employment in the industry and associated variability in hours worked from week to week (ABS 2009b).

### *Job satisfaction*

Overall job satisfaction of retail workers is slightly below satisfaction ratings recorded for workers in all industries. Data from the HILDA survey in 2009 show that 54.8 per cent of retail workers are very satisfied with their job which compares with 61.4 per cent of workers in all industries. Job satisfaction among retail casual employees (at 54.1 per cent) is similar to satisfaction for all workers in the retail industry (table 12.3).

Job satisfaction among retail workers is rated lowest against pay and hours worked and highest against job security and access to flexible working arrangements. Around 41.5 per cent of all retail employees are very satisfied with their pay levels which compares with 46.9 per cent of workers in all industries. Around 47.6 per cent of retail workers are very satisfied with their current hours of work which compares with 51.1 per cent of workers in all industries. Around two thirds of retail casual employees are very satisfied with their job security which compares with 71.0 per cent of all retail employees and 69.3 per cent of workers in all industries (table 12.3).

Retail casual employees are more satisfied with their pay and conditions of employment than other workers in the industry (i.e. permanent and contract employees). Around 46.7 per cent of retail casuals were very satisfied with their pay levels and two thirds were very satisfied with the flexibility to balance work and non-work commitments (table 12.3).

**Table 12.3 Job satisfaction among retail workers, 2009**

Category of job satisfaction	All retail workers	Retail casual employees	Workers in all industries	Casual employees in all industries	Permanent employees in all industries
	% of total	% of total	% of total	% of total	% of total
<b>Pay</b>					
Dissatisfied	14.5	11.0	11.8	12.5	10.1
Relatively satisfied	44.0	42.3	41.3	40.2	42.2
Very satisfied	41.5	46.7	46.9	47.3	47.7
TOTAL	100.0	100.0	100.0	100.0	100.0
<b>Flexibility<sup>a</sup></b>					
Dissatisfied	9.5	6.6	10.0	7.1	11.3
Relatively satisfied	32.7	28.0	30.8	27.8	32.6
Very satisfied	57.8	65.4	59.2	65.1	56.0
TOTAL	100.0	100.0	100.0	100.0	100.0
<b>Job security</b>					
Dissatisfied	5.2	6.0	7.1	9.9	4.3
Relatively satisfied	23.8	28.5	23.6	28.4	19.6
Very satisfied	71.0	65.5	69.3	61.7	76.1
TOTAL	100.0	100.0	100.0	100.0	100.0
<b>Hours of work</b>					
Dissatisfied	13.8	13.8	10.2	12.4	9.2
Relatively satisfied	38.7	42.5	38.6	38.1	38.4
Very satisfied	47.6	43.7	51.1	49.5	52.4
TOTAL	100.0	100.0	100.0	100.0	100.0
<b>Overall satisfaction</b>					
Dissatisfied	5.4	6.0	4.5	5.8	4.0
Relatively satisfied	39.7	40.8	34.1	36.6	34.1
Very satisfied	54.8	54.1	61.4	57.6	61.9
TOTAL	100.0	100.0	100.0	100.0	100.0

<sup>a</sup> Flexibility refers to the ability to balance work and non-work commitments.

Dissatisfaction ratings are the combination of those recording 0 to 4 out of 10 against each criteria, relatively satisfied are those recording 5 to 7 and very satisfied are those recording 8 to 10.

Source: Household Income and Dynamics in Australia (HILDA) Release 9.0 (2009).

### *Reasons why part time retail employees work part time*

The youthful demographic of the retail workforce is associated with the finding that around 44.0 per cent of part time employees in retail cited participation in education either at a school, college or university as the reason why they were working part

time hours. This compares with just less than a quarter of part time workers in all industries. Other major reasons cited by part time retail employees for working part time included caring for children (15.7 per cent) and a preference for part time work (13.6 per cent). A further 11.6 per cent of part time retail workers cited that they were working part time hours because they couldn't find a full time job (table 12.4).

**Table 12.4 Major reason for part time employees working part time hours, 2009**

Reason	Part time retail employees	Part time employees in all industries
	% of total	% of total
Own illness or disability	3.4	4.4
Caring for children	15.7	21.6
Caring for disabled or elderly relative	0.9	0.9
Other personal or family responsibilities	1.1	2.4
Going to school, college or university	44.0	24.1
Couldn't find full time work	11.6	9.0
Prefer part time work	13.6	24.9
Prefer job and part time hours are part of the job	8.6	10.7
Other <sup>a</sup>	1.1	1.9
TOTAL	100.0	100.0

<sup>a</sup> Other includes involvement in voluntary work; attraction to pay premium associated with part time casual work; welfare payments may be affected by involvement in full time work; getting business established; and other personal and family responsibilities.

Source: Household Income and Dynamics in Australia (HILDA) Release 9.0 (2009).

### *Labour turnover rates*

Labour turnover is higher in retail than in other industries. For example, around a quarter (23.8 per cent) of employees in retail had been with their current employer for less than 12 months in February 2010, which compares with the all industries average of 18.0 per cent. Further, retail employees are less likely to form a long term attachment with an employer than employees in other industries — 15 per cent had been with their current employer or business for ten years or more which compared with just under a quarter (24.4 per cent) of employees in all industries (ABS 2010h).

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Service Skills Australia noted that while workers in retail have higher labour mobility rates than workers in other industries, feedback from Industry Service Centres confirmed that many retail workers remain in the industry and move from firm to firm rather than stay with the one employer for an extended period of time (sub. DR182, p. 2). While there is some movement of employees between retail establishments, employers are faced with the prospect that over 40 per cent of their part time staff are currently attending an educational institution (table 12.4) and a substantial proportion will eventually leave the industry when they have graduated and found employment relevant to their qualifications.

In summary, retail workers tends to be younger than average, are more likely to be female, are generally lower skilled than workers in general, have a greater tendency to be employed on a part time and casual basis, and are more likely to change jobs and/or careers than workers in other industries.

#### *Employer views on the need for flexibility in the retail workforce*

The characteristics of the retail workforce highlighted above are a reflection of changing requirements of employees for more flexible forms of employment as well as the need for retailers to have a more flexible workforce to deliver their services more efficiently. For example, Myer noted in its submission that there has been a structural shift in employment in retail from predominantly full time employees to a more flexible workforce.

This flexibility gives Myer store management the ability to adjust the workforce depending upon demands of customers and fluctuations in sales. (sub. 88, p. 13)

Myer also added:

A part time and flexible workforce enables us to roster employees on the days and at the times consumers want to shop. It also facilitates the desire of some of our workforce who also want the flexibility to work at differing times to the 'traditional' working week. This is particularly important to our 'student' workforce as well as to parents who want to work rosters planned around study, family and school obligations. (sub. 88, p. 13)

Woolworths noted the importance of flexible employment opportunities offered by retail in its submission:

The sector provides a unique environment that enables those requiring flexibility and special needs to access employment opportunities including women, older workers and those living with a disability. (Woolworths, sub. 110, p. 12)

The Australian National Retailers Association (ANRA) also noted in its submission:

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One of the main reasons that retail is an attractive sector for students and women is the flexibility the sector offers its employees. The wide availability of casual and part time work in the industry allows employees to balance their work with study and caring responsibilities. Indeed, retail provides many Australians with their first job – usually casual employment while they are studying. (ANRA, sub. 91, p. 35)

While evidence from submissions point to the benefits of greater flexibility of the retail workforce, as discussed in Chapter 11, some retail employers have found workplace regulation and new modern awards are to some extent restricting workplace flexibility.

### **Impact of online retailing on employment**

There are a diverse range of views on the employment outlook for the retail industry, particularly in relation to the impact of growth in online shopping. These are summarised in box 12.1.

The National Retail Association (NRA) predicted the loss of between 53 000 and 105 000 jobs in the industry over the next five years based on the loss of retail sales from bricks and mortar establishments to offshore online retailers and stagnation of domestic online sales. The higher estimate for employment loss is based on a much higher online penetration rate of 12 per cent by 2015 while the lower estimate is based on an online penetration rate of 8 per cent.

A separate report prepared by the Allen Consulting Group for eBay had a different assessment for labour market impacts of online retailing which noted the positive impact of growth in *domestic* online retailing on employment and the offsetting impact of a decline in employment in bricks and mortar establishments — the overall magnitude of net employment loss was expected to be small.

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### Box 12.1 Impacts of online sales on retail trade employment

- The National Retail Association (NRA) sees the possibility of between 53 000 and 105 000 jobs being lost from domestic retail stores to overseas 'pick and pack operations' over the next five years due to growth in online shopping (NRA, sub. 102). These projections are based on the assumption that all of the increase in the online share of total retail sales over the next five years is accounted for by overseas retailers.
- The Allen Consulting Group noted in its submission on behalf of eBay that the composition of employment in Australia in the future will be affected by a number of structural changes in the economy, including the growth in new domestic online retailers, the expansion of existing online retailers, the relative decline in bricks and mortar retailing and the influence of overseas online retailers. The first two factors are expected to stimulate employment growth while the latter developments will have a negative impact. The Allen Consulting Group anticipated some short-term job loss in net terms as a result of online retailing but its magnitude is expected to be small. Online retailing is expected to have a positive impact on employment in the longer term. (eBay, sub. 101)
- Westfield were more pessimistic in its assessment of the impact of online shopping on employment:

Online retailers that can trade 24 hours a day have a competitive advantage over bricks and mortar retailers. This is unsustainable and will ultimately be to the detriment of retailers and their employees in a declining retail sector. Ultimately jobs will be lost and this will affect regions where restrictions [on trading hours] is toughest, such as South Australia. Job losses will also have a disproportionate effect on youth, of which retail is the largest employer. (sub. 103, pp. 33-34)
- The Retail Traders Association of Western Australia (RTAWA) expects employment levels within both retail and wholesale to fluctuate in the short term as they respond to technological changes and changing business models but to be steady over the longer term. (sub. 80)
- Analysts at IBISWorld estimated that the number of online enterprises in Australia would increase by 20.3 per cent per annum in the five years through to 2010-11, which would be comprised of new online start-ups and pre-existing retailers who would commence selling online for the first time. Employment was expected to grow by around 5.5 per cent per annum during the same period (MacGowan 2011).
- Analysts at Morgan Stanley projected that the impact of internet retailing will result in the loss of approximately 14 700 employees per annum (Kierath and Wang 2011).

#### *Commission's view of likely employment impacts of online shopping*

It is the Commission's view that growth of online retailing will result in a redistribution of employment through the economy. The combination of growth in

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the number of *domestic* pure play retailers, growth in sales activity of existing pure plays, and growth in activity of the online divisions of Australian multi-channel retailers will contribute to the redistribution of jobs away from bricks and mortar operations to online retailing and services such as website development and maintenance. Employment is also expected to shift to industries linked to retail such as transport delivery services and warehousing as a result of growth in online shopping.

Media reports confirm that some former multi-channel operators have shifted out of their bricks and mortar operations and are now restricting their business activities to online operations. For example, earlier in 2011, Borders closed its nine remaining stores across Australia with the loss of 315 jobs. In total Borders lost 1675 staff, but has retained its online presence at this stage. Angus and Robertson announced the loss of 519 jobs as the result of store closures. Angus and Robertson has also maintained their online presence.

The Commission anticipates some structural employment loss in retail as the result of continued growth in *overseas* online sales — particularly from bricks and mortar retailers. However, the extent of the loss in employment is more difficult to predict.

The Commission considers that growth of online shopping in the future will be shared between domestic and overseas online retailers. The magnitude of the share garnered by Australian retailers will depend upon the extent to which they take advantage of opportunities created by online retailing and adapt their business formats to meet changing consumer preferences. As discussed in Chapter 4, a number of surveys have indicated that around 70 per cent of Australians prefer to shop online with domestic retailers, which implies that if domestic retailers respond positively to the challenge of online shopping, they have good prospects of securing market share of future growth in online sales. The size of domestic online market share will also depend upon whether Australian consumers have positive or negative experiences with online purchasing from overseas websites.

While official statistics show that growth in non-store based employment in retail has so far been relatively subdued, stronger growth in employment in this sector is likely in the future, along with the online divisions of multi-channel establishments.

## **Employment growth projections for retail**

The impact of online retailing on employment in the industry will occur in the broader context of employment change within the industry in response to macroeconomic developments and other changes in consumer spending patterns. The nature of broader changes in the retail landscape will place greater or lesser

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pressure on the retail industry depending on how it responds to the growth of online retailing and the need to close the productivity gap with overseas retailers (see chapter 11). Reports by private analysts presenting forecasts of the employment outlook for industries, including the retail industry, assess the opportunities for and threats to the industry usually with a short to mid-term focus. Such analyses can include quantitative modelling or qualitative judgements which attempt to identify and analyse key factors affecting employment in retail including factors such as movements in wages, housing prices, interest rates and consumer sentiment.

Employment projections by analysts show relatively weak employment growth for retail over the next five years compared with other industries. The Department of Education, Employment and Workplace Relations (DEEWR) has predicted that employment growth in retail will average 1.2 per cent per annum through to 2015-16 which compares with overall average annual employment growth for all industries of 2.1 per cent. Deloitte Access Economics show moderate annual employment growth for retail through to 2014-15 — ranging between 0.6 per cent and 1.1 per cent per annum (box 12.2).

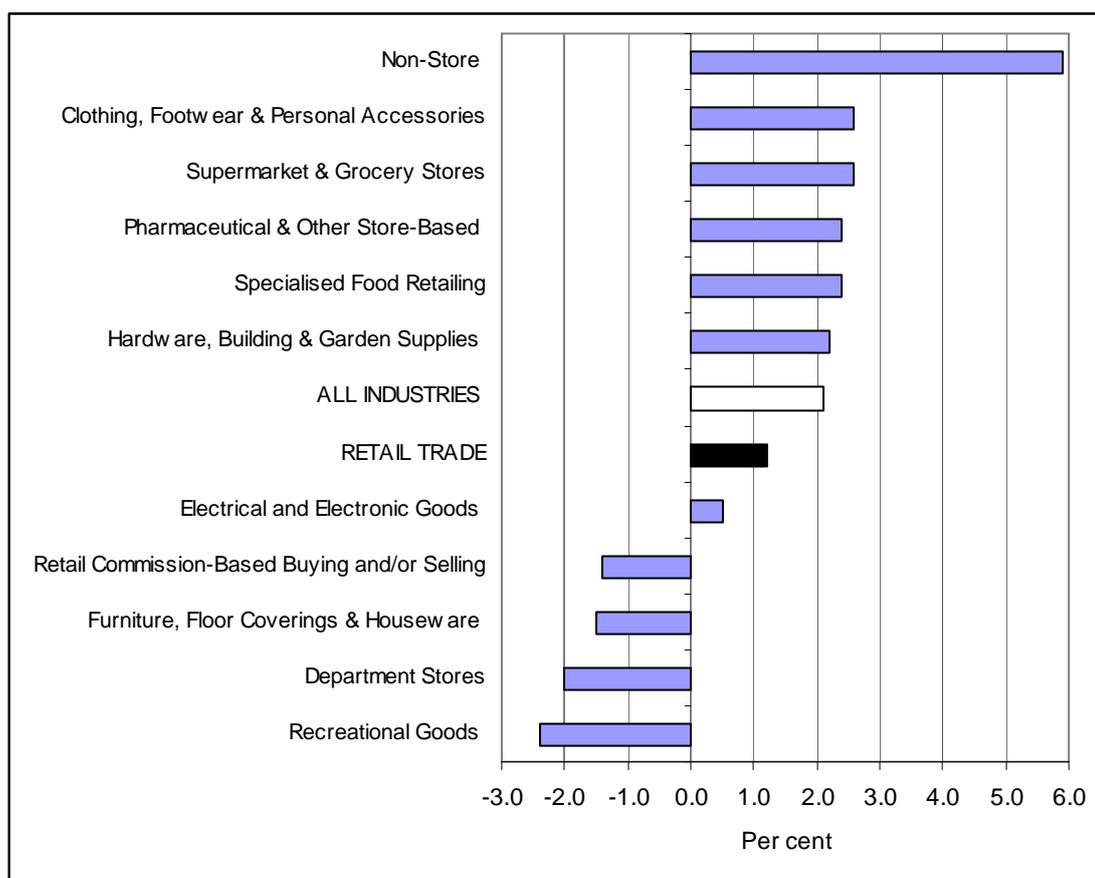
Jobs growth over the next five years is expected to vary considerably by industry subdivision. DEEWR has projected that department stores will continue to shed jobs over the next five years at the rate of 2.0 per cent per annum while employment growth is expected to be strongest in non-store based retail which includes online retailing — at 5.9 per cent per annum.

The current outlook for the retail industry provided by analysts is for the continuation of relatively subdued growth in sales activity, which if realised, and combined with increased competition from online overseas retailers, will place greater pressure on bricks and mortar retailers to make adjustments to their workforce. Despite these pressures on individual retailers, analysts' projections show positive employment growth for the industry over the next five years, but at a slower annual average rate than that recorded over the previous fifteen years.

## Box 12.2 Employment projections for retail trade

- The Department of Education, Employment and Workplace Relations (DEEWR) provides employment growth projections by industry sector for the retail industry. Employment growth between 2010 and 2015-16 (excluding motor vehicles, fuel and motor vehicle parts and tyres) was expected to be strongest in non-store retail — up 5.9 per cent per annum. Employment is expected to contract most sharply in department stores (down 2.0 per cent per annum) and recreational goods retailing (down 2.4 per cent per annum).

### Employment projections by sector – 2010 to 2015-16<sup>a</sup>



<sup>a</sup> Excluding motor vehicles, fuel and motor vehicle parts and tyres.

Source: DEEWR (2011) unpublished data.

- Deloitte Access Economics projected that employment in retail trade would grow by 1.1 per cent in 2011-12, followed by 1.6 per cent in 2012-13, 0.7 per cent in 2013-14 and 0.9 per cent in 2014-15 (Deloitte Access Economics 2011).

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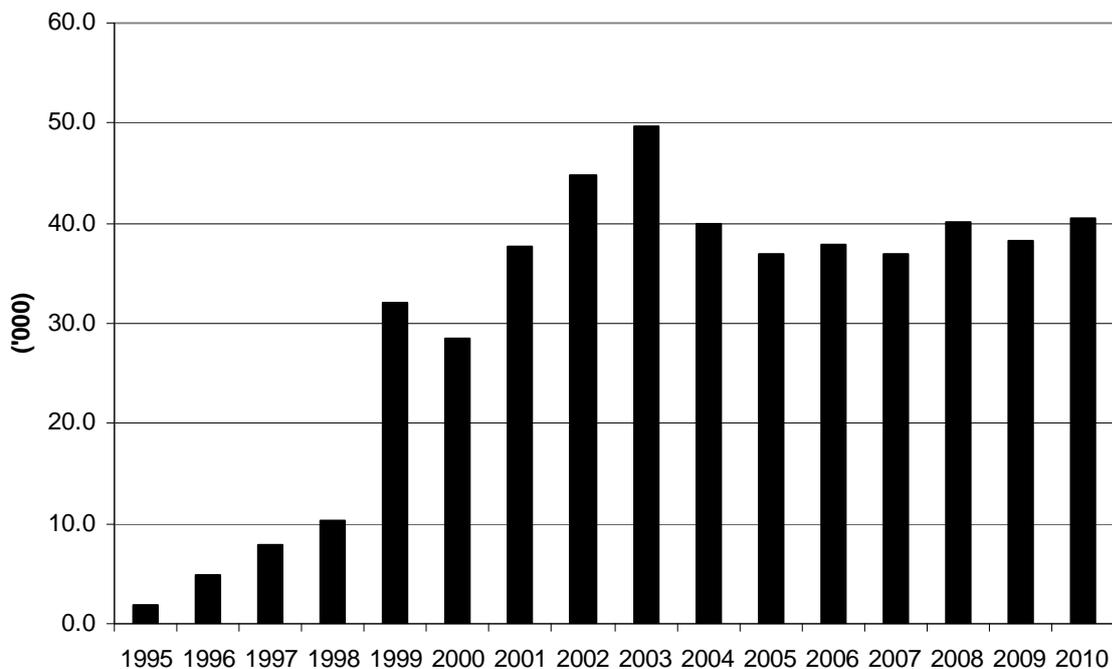
## 12.2 Training

### Institutional arrangements for the delivery of retail industry training

The major source of supply of qualified retail employees is graduates of vocational education and training courses offered in colleges, community centres and Technical and Further Education (TAFE) institutes. Larger retailers also run their own in-house training programs. Entry into careers in retail is usually at the Certificate II level while training in supervisory skills is also available at the Certificate III level. Training at these lower levels is usually deemed suitable to the skills needs of industry and represents an appropriate starting point in the sector. Engagement in higher Australian Qualifications Framework (AQF) levels in the retail industry (such as Certificate IV and Diplomas which provide managerial skills) are typically low.

Data from the National Centre for Vocational and Education Research (NCVER) show that training commencements for sales assistants and sales persons grew strongly between 1999 and 2003 — peaking at 50 000. Training commencements have since fallen and settled at around 40 000 per year (figure 12.4).

**Figure 12.4 Training commencements — sales assistants and salespersons, 1995 to 2010**



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Source: NCVER (2010).

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Poor completion rates of traineeships for sales workers may be contributing to lower rates of skilled labour supply to the retail industry. NCVER data show around 44.8 per cent of sales workers in 2007 completed the training they had commenced, which compares with an industry average of 50.3 per cent (Apprenticeships for the 21<sup>st</sup> Century Expert Panel (2011)).

Unlike other occupations in other industries there is no general requirement to complete this form of training to work in the retail industry. The high non-completion rate may also reflect the high level of staff turnover in the industry. Four major reasons were cited in a report into the apprenticeship system for low completion rates of apprenticeships generally (including retail apprenticeships) — workplace or employer issues (including perceptions by apprentices of poor employment conditions, long hours, and unpaid hours of work); lack of support from employers; relatively low wages; and dissatisfaction with the nature of the work (Apprenticeships for the 21<sup>st</sup> Century Expert Panel (2011)).

In its submission following the release of the Commission's draft report Service Skills Australia provided a number of alternative explanations based on a small survey of retail workers (150 persons) for why some retail workers fail to finish their traineeship. These mainly include personal or work related reasons or caring responsibilities rather than dissatisfaction with the quality or value of training (sub. DR182, p. 2).

Many of the reasons provided for non-completion were short-term such as pregnancy, illness, home relocation, job change, or caring for relatives. But by far the major reasons (45 per cent of respondents) for non-completion remain related to changes in work circumstances such as resignation from a job, finding a job elsewhere, or the termination of employment (Service Skills Australia 2011).

### **Employer use of formal training in retail**

NCVER data show that employers in retail are less likely than employers in other industries to use the Vocational Education and Training (VET) system for their training needs. Around 45.2 per cent of retail employers used the VET system in 2009 which compares with 54.0 per cent of employers in all industries. However, 27.7 per cent of retail employers had trainees as part of their workforce in 2009 which was just under the industry average of 30.6 per cent (NCVER 2009).

Employers in retail were more likely to use unaccredited or informal training than training provided by the VET system — 58.3 per cent of retail employers used unaccredited training in 2009 while 80.1 per cent used informal training. By

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comparison 52.7 per cent of employers in all industries used unaccredited training and 76.8 per cent used informal training.

This information suggests that employers in the retail industry do not perceive that having a VET qualification is as important to meeting their industry skill needs as do employers in some other industries — most notably employers in industries requiring higher formal skills such as construction, manufacturing and mining. Employees in these industries are more likely to need technical training to acquire specific skills as part of their duties such as operating light and heavy machinery with precision and safety. Retail workers require training in tasks such as customer service, stock control and operating point of sale equipment.

But retail employers who do use the VET system for their workforce training are almost as satisfied with that training as employers in other industries. Just under 82 per cent of employers who used nationally recognised training were satisfied with training delivered as a means of meeting their skill needs. The satisfaction rating was little changed from 2007, and was slightly below the industry employer satisfaction average of 85.8 per cent (NCVER 2009).

HILDA survey data confirm that retail employers are less likely to train their staff than employers in other industries. For example, just less than a quarter of persons employed in retail in 2009 had undertaken work related training in the previous 12 months compared with just over a third of persons employed in all industries (table 12.5).

Full time and permanent staff in retail (and other industries) were more likely to receive training than employees who were working on a casual and/or part time basis. However, permanent employees in retail were far less likely to receive training than permanent employees in all industries (29.8 per cent versus 41.7 per cent) (table 12.5).

While official data available are relatively dated, employers in retail appear to invest less in training than employers in other industries. Employers in retail spent less than one per cent of the amount they spent on wages and salaries on training in 2001-02, and on average spent less than one third on training per employee as that invested by employers in all industries (NCVER 2007).

**Table 12.5 Access to training in the past 12 months, 2009**

	<i>Retail trade</i>	<i>All industries</i>
All employees		
Yes	24.7	34.8
No	75.3	65.2
Total	100.0	100.0
Casual employees		
Yes	20.7	23.3
No	79.3	76.7
Total	100.0	100.0
Permanent employees		
Yes	29.8	41.7
No	70.2	58.3
Total	100.0	100.0
Part time employees		
Yes	21.8	28.4
No	78.2	71.6
Total	100.0	100.0
Full time employees		
Yes	28.2	37.9
No	71.8	62.1
Total	100.0	100.0

*Source:* Household Income and Dynamics in Australia (HILDA) Release 9.0 (2009).

It is difficult to conclude whether the retail workforce receives the appropriate level of training relative to their needs when making comparisons with the level of training provided to employees in other industries. While training rates for retail employees have been demonstrated to be lower, the retail industry is characterised by relatively low skilled workers, and it is probable that the training requirement for retail personnel is lower in a formal sense, than that required by workers in other industries.

### **Changes to Government assistance to encourage employers to take on retail apprentices**

ANRA (sub. 91) argued that the Australian Government has a role in the training of retail employees and noted concern at one of the recommendations from the recent review of apprenticeships titled *A Shared responsibility: Apprenticeships for the 21<sup>st</sup> Century*. The recommendation called for the Australian Government to:

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Redirect current Australian Government employer incentives to provide structured support services to eligible apprentices and trainees and their employers in occupations that are priorities for the Australian economy. While a wide range of occupations should be trained through apprenticeship and traineeship pathways, Australian Government support should focus on occupations that have tangible and enduring value for the economy — both in traditional trades and the newer forms of apprenticeships and traineeships, such as community services, health services and information technology. (Apprenticeships for the 21<sup>st</sup> Century Expert Panel 2011, p. 14)

The Expert Panel made it clear under this recommendation that training funding should be directed to occupations in industries that provide ‘a tangible and enduring value for the economy’ such as community and health services and information technology (Apprenticeships for the 21<sup>st</sup> Century Expert Panel 2011).

ANRA is concerned that retail apprenticeships may not be classified as ‘eligible apprentices’ under this recommendation which ‘could result in a critical loss of support for apprentices in the industry’ (sub. 91, p. 37).

ANRA also stated:

Successful training programs depend on a three-way commitment from employers, employees and government. Any reduction in the role of government support would put at risk future training of the retail workforce. (sub. 91, p. 37)

The Australian Council of Trade Unions (ACTU) also registered similar concern at recommendations to cease government incentive payments for retailing, noting that this would have a negative impact on the sector’s capacity to attract and retain a quality labour force (sub. 100).

The NRA made similar comments.

The Australian Government announced in the May Budget that it would immediately discontinue the allocation of funding to retailers in connection with the delivery to their staff of a Certificate II qualification. The impact of the withdrawal of funding will be both less training and the inevitable diminution of service standards and productivity, or increased costs for retailers as they fully fund the training effort. Neither is a welcome outcome. (sub. 102, p. 45)

And the Shop, Distributive and Allied Employees Association stated:

Whilst it is arguable that some employers have abused the current system and that the current system is in need of reform, such a drastic action [of removing government incentives for retail training], if implemented, would almost certainly have the impact of bringing about a severe cut to the amount of accredited training delivered in and to the industry. (sub. 18, pp. 5-6)

The Australian Government acted quickly to remove universal access to Certificate II incentives in the May Budget but there has not been a shift to

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prioritising particular occupations or industries at this stage. The Budget Papers show that from 11 May 2011 the commencement incentive of \$1250 will only be available to employers if the relevant employee is from a nominated equity group which includes: Indigenous Australians; Australian apprentices with a disability; Australian school-based apprentices; mature aged Australian apprentices (aged 45 years or more); Australian apprentices working in a rural or remote area; and job seekers with severe barriers to employment. The same conditions apply for the \$1000 completion incentive for Group Training Organisations.

While the changes already made to incentive arrangements may affect payments to employers in retail it is not because the industry has been specifically targeted but because incentive payments have been altered universally so that they are directed towards those who are most in need.

The Expert Panel stated in its report into the apprenticeship and traineeship system that industries such as retail and hospitality have benefited considerably from the introduction and expansion of financial training incentives, but there is not much evidence of significant increases of numbers of Australian apprentices in traditional trades where shortages of supply have been identified. For example, only a third of total incentive payments go to areas experiencing skill shortages. This caused the Expert Panel to reassess the benefits of persisting with current funding arrangements.

... for some traineeships, for example in retail and hospitality, financial incentives to employers have led to a large increase in trainees...in some instances, particularly for retail and hospitality qualifications, the incentives currently paid constitute an implicit wage subsidy to the employer of 20 per cent ... we question whether the significant government funds being spent on employer incentives for these qualifications are providing any tangible benefit to the broader economy. (Apprenticeships for the 21<sup>st</sup> Century Expert Panel 2011, p. 58)

This finding is supported by research conducted by NCVET for the Australian Fair Pay Commission:

... the scale of the implicit wage subsidy ranges from the relatively trivial to the generous; it is smaller for employers hiring apprentices than it is for trainees, a situation which on the face of it is at odds with skill shortages faced in the trades in recent years. (Cully 2008, p. 275).

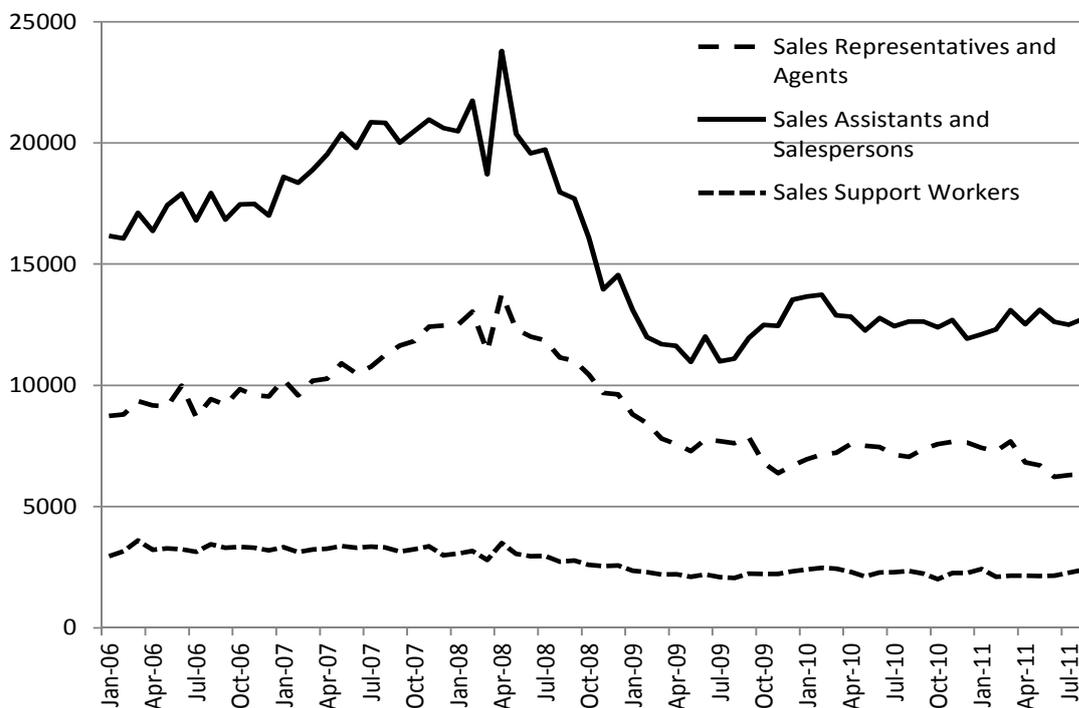
The NCVET found that incentive payments for trainees in retail trade totalled \$112.8 million in 2007 which accounted for 16.5 per cent of all incentive payments for apprentices and trainees, and around 0.29 per cent of the total wage bill for the industry. The industry average for training incentive payments share of the total wage bill was half that figure (at 0.15 per cent) (Cully (2008)).

This information highlights that retail employers may have been receiving a generous amount of training incentive funding over the past decade at the expense of employers in industries where skill shortages are more prevalent. Analysis of the extent of skill shortages in retail are discussed in more detail in the following section.

### 12.3 Are labour shortages and skill levels affecting the retail industry?

Demand for labour in retail, as measured by levels of skilled vacancies lodged on internet employment websites, fell between early 2008 and mid 2009 (DEEWR 2011). Vacancies have recovered slightly for sales assistants and sales persons since but have continued to plateau for sales representatives, agents and sales support workers (figure 12.5).

Figure 12.5 Vacancies for sales workers in Australia, January 2006 to July 2011



Source: Internet Vacancy Index (IVI), DEEWR (2011); seasonally adjusted data. The IVI is based on a count of online vacancies lodged on websites such as SEEK, My Career, CareerOne and Australian JobSearch.

DEEWR data indicate that skill shortages in retail are less acute than in other industries with employers in the industry having more suitable applicants to choose

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from than employers in other industries. Retail also has a lower rate of unfilled vacancies than other industries. This is perhaps unsurprising given the lower skill profile of workers in the retail industry.

The results of the DEEWR *Survey of Employer's Recruitment Experiences* show that in the 12 months to December 2010, 4.7 per cent of vacancies in retail remained unfilled, which compares with an all industry average of 7.1 per cent. In the most recent recruitment round conducted by employers there were 2.6 suitable applicants available per vacancy, which compares with an industry average of 2.4. Around 32 per cent of employers in retail expected to experience recruitment difficulties in the next 12 months which compares with 42 per cent of employers in all industries (DEEWR 2010c).

### **Has there been a decline in customer service skills of retail employees?**

Feedback from meetings the Commission has conducted with retail establishments, as well as submissions from retailers and consumers, point to a general deterioration in service skills of retail workers due to either a lack of expertise and/or attitudinal problems.

Red Herring Surf commented:

Staff dedicated to customer service perhaps is the strongest issue when it comes to recruiting staff. There are plenty of industry training institutions offering retail training certificates, however retail is not often perceived as a career choice for some and people often work in retail to get themselves through Uni or for extra pocket money. This can be extremely hard for retail employers to manage/balance. (sub. 41, p. 6)

Some consumers also voiced their disappointment at the quality of service provided by bricks and mortar retail staff in Australia when compared with their experiences with online shopping:

There is a real concern on the part of online marketers that their service, product, and communication receives 100% approval and satisfaction avoiding any negative response to ensure the future of their online business. I have found that the same does not apply to local retail salesmen – making the sale and obtaining the payment is the key criteria and objective not service. (Rodney Popham, sub. DR163, p. 3)

Another online shopper commented:

I get better customer service from online sites than I do from retail shops as this is how the online sites do business. It seems that the retail shops here prefer to have me forced to buy from them rather than have me want to buy from them. (Gerry Affat, sub. 12, p. 1)

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However, this expectation by retailers and consumers needs to be balanced by factors which may impinge on the ability of employees to provide satisfactory levels of service. A number of union submissions attributed the decline in consumer service to reductions in staff numbers. For example, United Voice submitted:

Far from implementing strategies to deliver sustainable returns over the long-term, many retailers have chosen the “low road” pursuing short-term profits by reducing their numbers of staff and increasing levels of casualisation. ... this ultimately leads to poor customer service, with the end result being that consumers simply spend their money elsewhere. (sub. DR197, p. 5)

The erosion of customer service skills in retail can't be pinned on workers alone — the industry has failed to recruit, train and retain workers, with the sector experiencing high levels of turnover. (sub. DR197, p.6)

The ACTU pointed to the link between improving the skill base and higher quality service:

There is a growing understanding of the link between maintaining skilled and experienced employees and high quality customer service. Those retail businesses which have invested in employee training and development are amongst the highest performing retailers in Australia. (sub. 100, p. 5)

Coles mentioned that a number of initiatives can deliver better outcomes for retail businesses including improving customer service:

Improving customer service, efficiency and training/development of employees and simplifying business operations, improves productivity and reduces the cost of doing business. (sub. 79, p. 10)

Declining customer service skills is a factor which may explain part of the difference in the level of productivity performance between retail workers in Australia and countries such as the United States. However, there is a need for more research in this area to identify whether a decline in customer service standards has actually occurred in Australia and the strength of the relationship between customer service and productivity.

Part of the reason for the perception of poor service standards in the industry could be due to retail jobs often being temporary stepping stones to employment in other occupations and industries for young retail workers combining study with part time work in the industry. Compounding this situation is the existence of high labour turnover rates in the industry. This provides less incentive for employers to develop training strategies which will contribute to improved employee productivity performance and perhaps explains some of the attitudinal problems of some workers.

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## Changing skill requirements in the industry

A number of skills are likely to be in demand in the future due to sustained growth in online retailing. These include: administrative staff required for technical support, updating databases and website maintenance; staff for transport services to deliver physical merchandise; electronic financial service skills including security systems specialists, online consultants and specialists; and IT professionals such as computer engineers. Other skills and occupations in demand include IT consultants and software and website developers; photographers and people with graphic art and creative skills to develop and maintain content on websites to encourage sales (eBay, sub. 101).

ANRA sees a need for retail skills to accommodate technological developments including growth in m-commerce. It was envisaged that skills in the future may shift from selling to facilitating delivery of items that astute customers, familiar with the latest technology, have already identified they are interested in purchasing.

Critically the style of retail skills will also need to change to meet the needs of new technology and the ever increasing prospect of m-commerce enabled shoppers. These shoppers have done their research out of store and have a clear idea of the goods they want. The in store staff role may be less about 'selling' and more about facilitating the immediate delivery of the item. This customer will expect staff-in-store to connect directly with company inventory and supply chain information via technology, such as the already available UPS applications for supply chain management, and provide immediate details and capacity to finalise a purchase. The implications from a training perspective for many retailers is the need to recognise this increase in technology reliance. (sub. 91, p. 37)

Some of the online 'pure play' organisations the Commission spoke to cited difficulties in recruiting people with good IT skills who had knowledge of website interface technology as well as people with strategic knowledge of the online shopping sector. These people are highly skilled and can command high salaries. This contrasts with the lower skill sets of retail shop assistants whose major deficiency is cited by some organisations as the lack of good communication and service skills.

PayPal claimed that larger firms and multi-channellers face greater challenges with recruitment. Larger firms are more likely to be risk averse and avoid on-the-job training of staff to solve skill shortages and instead are more likely to recruit e-commerce professionals with proven ability to manage large budgets and more complex e-commerce projects. They are more likely to recruit these professionals from overseas given the relatively small and undeveloped e-commerce market in Australia (PayPal 2010).

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Consultations with leading employers and employer associations confirmed evidence of shortages of IT skills for retailers with online websites, particularly employees with knowledge of online marketing and web interface systems that involve security arrangements necessary in financial transaction e-commerce environments. These skills are scarce and suitably qualified staff can receive large salaries, and are often poached from other companies and/or sourced from overseas. There is potential for training in Australia to be targeted at these skills given the projected growth in online sales in the medium term.

The RTAWA saw opportunities for productivity gains through improved training within retail:

Productivity gains could be enhanced by improved training within the industry, but with the staff churn, there is a reluctance to invest in this area. There is also a shortage of experienced, knowledgeable, retail specific training personnel. (sub. 80, p. 16)

One market analyst envisaged that Australian online retailers will struggle with respect to capacity constraints especially with regard to skilled labour. It was considered that Australian retailers will find it increasingly difficult to recruit professionals with knowledge of eBusiness and strategic online development skills from North America and Europe, and as a result, will be forced to promote more aggressively internally (Forrester 2011).

A survey of 500 CEOs in 2008 identified that small firms are more likely than larger firms to lack the skills and capabilities to take advantage of the commercial opportunities likely to arise from a faster broadband network in the future. The results of the survey also confirmed that firms in retail did not have the same capability as some other sectors to capitalise on the advantages from faster broadband technology. CEOs identified a number of options to solve skills and capability problems associated with adopting the new technology. Around 58 per cent of respondents across all industry sectors indicated they would train existing staff to improve capabilities, a quarter would sub-contract to fill the skills gap, 12 per cent would hire new staff and 6 per cent would use labour hire (AiG and Deloitte 2008).

## 12.4 Conclusion

Historically, employers in the retail industry have relied on a younger workforce who are relatively unskilled and are mostly working on a part time and casual basis. Females also account for a relatively large share of the retail workforce. Turnover of the retail workforce is high when compared with the industry average, which acts as a disincentive for employers to invest in training staff. The younger age profile of

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the retail workforce and the extent of labour turnover are consistent with general feedback from industry sources that relatively few employees establish long term careers in retail occupations.

From a retailer's perspective, increased flexibility of the retail workforce in terms of a greater proportion of part time and casual employees than in the past, provides the opportunity to quickly adjust labour requirements to accommodate changes in consumer demand. Other forms of flexibility include the adoption of other workplace practices which improve customer service and labour productivity.

While evidence from submissions points to greater flexibility to adjust workforce size and hours worked, there is also evidence of some retail employers finding workplace regulation and new modern awards are to an extent restricting desired levels of workplace flexibility. These issues are discussed in more detail in Chapter 11.

In the future, retailers will also be under significant pressure to reduce their costs (and particularly labour costs) as the competitive influence of online retailers and other new entrants to the retail sector grow. While bricks and mortar retailers will want to enhance customer service, they will also need to become more price competitive, which will likely see a reduction in employee numbers. The extent of any reduction is unclear.

From another perspective, the actions of bricks and mortar retailers who embark on multi-channelling strategies and other innovative responses to increase their competitiveness, may well stimulate employment growth. However, the net impact for any specific individual or sub-segment of retailers is harder to predict with any certainty.

The retail sector in the future will also require a more highly skilled workforce including employees with good IT skills who have knowledge of website interface technology to support the move into online retailing. To the extent that retailers choose to compete on the services they offer rather than primarily the price they charge, there may be greater need to develop a workforce with higher customer service skills and a longer term commitment to the retail industry. This can be achieved by employers providing higher rates of training to develop relevant skills, the development of incentives to encourage employee productivity, and the pursuit of higher rates of employee retention to capitalise on investment in training.



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## 13 Other regulatory burdens

### Key messages

- Participants have many concerns about regulations at the federal, state, territory and local government levels that, in their view, are hindering the retail industry's ability to respond efficiently to the demands and preferences of consumers.
- Amongst these are concerns about regulations that impact specifically on the retail industry such as requirements relating to compliance labelling and the sale and/or display of certain products such as tobacco, alcohol, knives and restricted DVDs. Other concerns relate to more generic regulations — such as transport, environmental, occupational health and safety, workers' compensation and taxation regulations — that need to be examined in a broader context where the interests of all affected industries can be considered.
- Many of the concerns relate to inconsistencies in regulations across jurisdictions. Retailers that operate across jurisdictions are experiencing inefficiencies in their operations as a result of such differences in regulations.
- Several of the concerns raised are not new and have been examined in previous Commission or other review processes. Others are the subject of ongoing review processes, for example, as part of the COAG national seamless economy reform agenda.
- It has not been feasible for the Commission to respond in detail to each concern. However, the issues raised highlight the need for governments to continue to prioritise efforts directed at the review and reform of regulations that are unnecessarily burdensome and to reduce regulatory inconsistency across jurisdictions where that would afford net benefits to business and the wider 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.
- The specific regulatory concerns discussed in this chapter are best considered as part of the ongoing regulatory review processes of Australian governments, including those under the auspices of COAG.
- In considering the case for change in any of the specific areas identified, it is essential that the costs and benefits of reform options are carefully weighed, including the impacts on all stakeholder groups, not just those businesses directly affected.

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## 13.1 Introduction

Participants raised a number of concerns about regulations that, in their view, are hindering the retail industry's ability to respond efficiently to the demands and preferences of consumers. Some areas of regulation of particular concern to retailers have been discussed in earlier chapters, including intellectual property regulation, trading hours regulation, planning and zoning regulation, workplace regulations and customs regulations.

This chapter briefly discusses a range of other concerns about regulations at the federal, state, territory and local government levels that have been raised in this inquiry. Many of the issues relate to areas of regulation (such as taxation, superannuation, transport, and occupational health and safety regulation (OHS)) that, whilst significant for the retail sector, impact more generally across industries. Many are also the subject of ongoing COAG or other intergovernmental review and implementation processes — for example, OHS reform and national harmonised frameworks for the regulation of transport — or have been the subject of recent major reviews. These include the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, more commonly known as the Cooper Review and Australia's Future Tax System Review, more commonly known as the Henry Review.

The Commission does not intend to respond in detail to each concern. The large number and wide-ranging nature of the concerns raised means this is not feasible within the context of this inquiry. The issues that have been raised do, however, highlight the need for governments to continue to prioritise efforts directed at the review and reform of regulations that are unnecessarily burdensome and to reduce regulatory inconsistency across jurisdictions where that would afford net benefits to the community.

## 13.2 Concerns raised with this review

Several participants made a general comment about the heavy burden of regulations or what they perceived to be unnecessary 'red tape'. See, for example, Australian Retailers Association (sub. 71), Woolworths (sub. 110), Australian Music Association (sub. 68) and the National Baking Industry Association (sub. 1).

Others, while not necessarily suggesting that the burden of regulation was excessive or unnecessary, focused on the lack of consistency in its application between traditional retailers/importers using conventional channels on the one hand, and 'grey-market or consumer-imported versions of exactly the same product' on the

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other. Examples of regulations that are perceived to be applied (or enforced) inequitably, include consumer protection laws (chapter 5) and certain border and security measures (Martin Whitely JP MLA, sub. 119 and Australian Music Association (AMA) sub 68). The AMA also called for the Australian Government to examine the case for Australia's regulatory requirements to be harmonised with regulations in similar markets overseas, including in the case of Electromagnetic Radiation Compliance labelling requirements. This is consistent with recommendations made in various Commission reports (see for example PC (2008a) in relation to therapeutic goods regulation). The AMA submitted:

The fact that the Australian importer of a niche product has to spend significant amounts of time and money to recertify for standards which have already been signed off by authorities in similar jurisdictions seems not only superfluous but damaging to our economy. Now that consumers have the ability to import that very same product directly from another market means that the current regulatory burden has become farcical. (sub. 68, p. 8)

Similarly, Accord questioned whether unique Australian regulatory requirements impacting on formulated hygiene, cosmetic and specialty products are warranted. It called for the requirements to be removed if found to be unnecessary or, if they are essential for the protection of public safety, for the Government to ensure they are enforced, including in relation to direct overseas online purchases by Australian consumers:

Failure to pursue either of these policy pathways will continue to see the regulatory environment and compliance cost burden unfairly tilted against ethical and compliant makers, suppliers and retailers of formulated products. (sub. 75, p. 5)

Some participants suggest that regulatory impact analysis, to evaluate the likely costs and benefits of proposed new regulations or when reviewing or amending regulations, had in many instances been inadequate (see, for example the Direct Selling Association of Australia (sub. 95)) or in other cases had not been conducted at all. The Shopping Centre Council of Australia made the following comments in relation to the development of retail tenancy legislation:

Unfortunately it has been our experience that the costs imposed by retail tenancy regulation receive little consideration by governments before regulation is imposed. Although most governments require the preparation of some form of regulatory impact statement (RIS) to assess the costs and the benefits of proposed new regulations, it has been our experience in the regular reviews of retail tenancy legislation, including national competition policy reviews, that these cost assessments, if they occur at all, are perfunctory at best. Little real attempt is made to properly consider what new costs are being imposed on the retail tenancy market (both property owners and tenants and ultimately consumers as well) by the latest expansion of retail tenancy regulation, or whether the goals could be achieved by less intrusive means. (sub. 67, p. 42)

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Other process concerns that were raised included a lack of consultation in relation to some proposed reforms and duplication or a lack of coordination between reviews. ANRA (sub. DR190), for example, has a particular concern in relation to two parallel reviews that impact on food labelling. Similar issues have been raised with the Commission in the context of its annual reviews of regulatory burdens, and the Commission has emphasised the need for effective cooperation and coordination between regulatory agencies and review bodies, including across jurisdictions, in consultative and review processes (see for example PC 2009a).

*Other concerns — regulations having a particular or specific impact on retail*

A number of concerns were raised by participants in relation to regulations relating to the sale of tobacco and alcohol products, including:

- Coles (sub. 70) provided a number of reasons for why it does not support the regulations in certain jurisdictions that prohibit the sale of tobacco or alcohol online. More generally, Coles is also seeking the uniform application across Australia of regulations applying to the sale of tobacco and liquor products.
- The Australasian Association of Convenience Stores considers that state regulations that prevent convenience stores from selling alcohol ‘unfairly restricts the competitiveness of their offering’ (sub. DR146, p. 3).
- The Australian Newsagent’s Federation (ANF, sub. 99) submitted that tobacco control legislation, including retail display restrictions, were adversely impacting newsagency operators.

A particular concern for retailers operating nationally has been the differences across jurisdictions in highly prescriptive regulations covering the sale and display of tobacco products. Coles, for example, submitted:

... Coles, as a national retailer, has to comply with multiple policies in regard to signage, display, licensing, ticketing, definitions of tobacco products and sales to minors. (sub. 79, p. 19)

As an illustration of the nature and extent of variations across jurisdictions, table 13.1 summarises a selection of the regulatory requirements relating to the sale and display of tobacco products.

The rationale for such differences is not clear. It does not appear simply to be a case of one jurisdiction imposing more or less stringent rules than another, rather they are just different. It would seem, therefore, that there is a strong case for greater coordination and consistency between jurisdictions in the development of such regulation.

**Table 13.1 Sale and display of tobacco products, selected regulation<sup>a</sup>**

	<i>NSW</i>	<i>Vic</i>	<i>Qld</i>	<i>SA</i>	<i>WA</i>	<i>Tas</i>	<i>ACT</i>	<i>NT</i>
Licensing of tobacco sellers	yes	no	no	yes	yes	yes	yes	yes
Health warnings at point of sale	yes	yes	yes	yes	yes	yes	no	yes
Size of health warning	between 50 and 100 cm wide and min area of 0.2 m <sup>2</sup>	A3	410 x 290 mm	A3 <sup>b</sup>	297 x 210 mm	ns <sup>c</sup>		A3
Max size of price board	0.2 m <sup>2</sup>	1.5 x 1.5m	0.5 m <sup>2</sup>	0.5 m <sup>2</sup>	1 m <sup>2</sup>	75 x 100 cm	no price boards	1 m <sup>2</sup>
Font size on price board	no larger than 2 cm high and 1.5 cm wide	no larger than 2.1 cm high and 1.5 cm wide	ns	no larger than 2 cm high	no larger than 1 cm high	no larger than 2 cm high		no larger than 2 cm high and 1.5 cm wide
Max size of price tickets	35 cm <sup>2</sup>	ns <sup>d</sup>	80 x 40 mm	80 x 40 mm	35 cm <sup>2</sup>	ns	15 cm <sup>2</sup>	— <sup>e</sup>
Font size of price tickets	no larger than 2 cm high and 1.5 cm wide		ns	no larger than 15 mm high	no larger than 8 mm high	no larger than 2 cm high	12 pt New Roman	— <sup>e</sup>
Able to display cartons of cigarettes	no	no	no	no	no	yes <sup>f</sup>	no	no

<sup>a</sup> Different regulations apply to specialist tobacco retailers. <sup>b</sup> Displays of between 1 m<sup>2</sup> and 3 m<sup>2</sup> are required to display an A3 graphic warning. Displays of 1 m<sup>2</sup> or less are required to display an A4 graphic warning. <sup>c</sup> Retailers are provided with the sign. <sup>d</sup> Price ticket sizes are only specified for specialist tobacco retailers and vending machines. For general retailers, customers must not be able to read labels on storage units. <sup>e</sup> Price tickets are incorporated within the price board. <sup>f</sup> Cartons can be displayed if the only tobacco products sold are cartons.

ns: not specified

Source: NSW Health, 2009, *Guidelines for Tobacco Retailers in NSW*; Victoria Department of Health, 2010, *Tobacco Retailer Guide*; Queensland Government, 2010, *Queensland Tobacco Laws: Requirements for Retailers*; Government of South Australia, 2005, *Tobacco. Point of Sale Display Restrictions, Information for Tobacco Retailers*; Department of Health Western Australia, 2007, *Delivering a Healthy WA*; Department of Health and Human Services Tasmania, 2011, *Selling Tobacco Products in Tasmania. A Guide to Tasmanian Legislation*; ACT Health, 2009, *A Guide to the Sale of Smoking Products in the ACT*; Northern Territory Government, *Tobacco Control Act. Tobacco Retail Displays, Frequently Asked Questions*.

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Retailers that operate across jurisdictions experience inefficiencies in their operations as a result of the differences in regulations that exist between states and territories. Business systems designed to operate on a national basis, must be adapted to respond to specific state or local government laws. It can be costly for retailers in terms of different displays, signage and staff training requirements. The following comments are reflective of the views of many participants in the inquiry about the broader implications of such inconsistencies:

For retailers to manage and ensure they are compliant with all the various laws and regulations, requires additional resources at head office level as well as time spent by regional and state managers to carry out administrative duties rather than working to increase sales. (Adairs Retail Group, sub. 129, p. 2)

State-based regulation that is often inconsistently introduced and/or introduced without consideration of its impact on retailers ... directly impacts customers' convenience in store and indirectly impacts customers where Australian retailers must pass on the additional costs that arise from having to comply with a multitude of different regulations. (Woolworths, sub. 110 Attach. pp. 5-6)

Other inconsistencies in state and territory regulation, include:

- storage of dangerous goods legislation, state or region-based quarantine rules — for example, only honey which is made in Western Australia can be sold in Western Australia — and lotteries legislation (all raised by Coles sub. 79, with lotteries legislation also a concern for ANF (sub. 99))
- liquor licensing and food safety supervisor training (Restaurant & Catering Australia, sub. DR193)
- regulations banning the sale of knives to minors, and restrictions regarding the display of R18+ DVDs in South Australia (Woolworths, sub. 110).

The following are further examples of regulatory concerns raised by participants that either impact specifically on the retail industry or have a particular or major impact on the industry. Concerns relating to more generic regulations with wider impacts are discussed under a separate heading below (although the Commission notes that in a few instances a case can be made for including the regulatory concern in either category). The Commission has generally not included concerns that relate to prospective regulations or proposed changes to regulations.

- Retail tenancy legislation — retail tenancy leases, how they are regulated and recent review and reform activity is discussed in chapter 9. The Shopping Centre Council submission highlighted two specific case studies of provisions in state legislation that appear to impose unnecessary burdens, in the first case on landlords and in the second case on tenants:

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[Case study 1] In 2003, a provision was introduced in the Victorian Retail Leases Act (section 25) which requires, after a lease is signed, that certain details are to be notified to the Small Business Commissioner [e.g. names and addresses of property and parties, date of lease etc.] ...

In the eight years the Act has been in operation the Commissioner has had no reason to use this information in performing his functions and apparently has no plans to do so. Even if the Commissioner wanted to communicate directly with landlords and tenants, it is doubtful the information in the register would enable him to do so. ...

In other words, landlords are complying with this requirement for no public policy reason, and without any benefits to landlords and tenants, and at a significant cost. (sub. 67, p. 43)

[Case study 2] Retail property landlords in NSW who enter into a lease can no longer hold cash security bonds on behalf of tenants but, instead, must lodge those security bonds with the Rental Bond Board. ...

Not surprisingly, many major landlords have looked at the administrative complexity of the new scheme, and the possible long delay and additional expense in gaining access to the bond in the event of non-performance of lease obligations, and have decided they will no longer accept cash security bonds. Instead they now require prospective tenants to provide a bank guarantee. ...

This means it is now the tenant who has to spend the 'time and money' in arranging the necessary lease security, rather than the landlord. This is a commonsense response to over-regulation. (sub. 67, p. 44)

- Australian Consumer Law (ACL) — submissions indicate that the new consumer law (discussed more generally in chapter 5) has increased business compliance costs. Specific concerns, include:
  - allowing cancellation of a lay-by without explanation with 'the retailer having to bear most cost ... as prolonging the matter by debating what is 'reasonable' is a costly exercise' (Retail Traders Association of Western Australia, sub. 80, p. 10)
  - mandatory reporting provisions and requirements in relation to 'warranty as to defects' notices (Coles, sub. 70, p. 11)
  - unsolicited selling provisions that are seen as poorly designed, replicate generic provisions in the ACL, are unduly prescriptive, uncertain, biased and ill targeted and restrictive of competition and consumer choice (Direct Selling Association of Australia, sub. 95, p. 8).
- Registration and licensing obligations imposed on retailers — Myer described the number of requirements as 'unduly complex, [and] inconsistent' and imposing 'a significant cost and administrative burden' (sub. 88, p. 17) and Restaurant & Catering Australia stated that 'registration and licence fees for small business need to be consistent ...' (sub. DR193, p. 11).

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- Food labelling — the New South Wales Government has introduced a requirement that major fast food outlets display kilojoule information alongside the price on their menu boards, menus, websites and leaflets and some other jurisdictions are considering or have announced plans to introduce similar schemes. Woolworths states that ‘an unintended consequence of the regulations has been the capturing of supermarkets who sell similar food to fast food retailers ... [and the] ... NSW Act was introduced with no consultation with supermarkets ...’ (sub. 110, p. 49).
  - Compulsory fortification of bread products with folic acid and iodised salt — the National Baking Industry Association suggests that:
 

... the Government should perform further research into whether an over-supplement of folic acid can result in any detrimental affect on an individual. ... and that the Government desist in any further legislation which will mandatorily control the way in which bakers can produce their products e.g. level of substances, thereby limiting the taste of products and reducing consumer choice. (sub. 1, pp. 9-10)

*Other concerns — regulations with wider or more general impacts*

The following are examples of concerns raised by participants that relate to regulations that are more generic in their application and impact, rather than having a specific or particular impact on the retail industry:

- Goods and Services Tax— while the Tourism & Transport Forum recommended that changes be made to permit more purchases by international visitors to be GST-free or eligible for GST refund through the Tourist Refund Scheme (sub. 111 and DR216), there were also calls for all domestic GST exemptions to be eliminated because the ‘cost of administering exemptions exceeds any benefits’ (Gilmour’s Pty Ltd, sub. 43, p. 4).
- Duplication, overlap and a lack of uniformity in reporting and data collection requirements — Gilmour’s Pty Ltd, for example, stated:
 

... too many ‘authorities’ seeking information from businesses in too many different formats. Reports demanded by Federal and State taxing authorities are extracted from the same data, but they all want it in different formats. ...

... each workers’ compensation authority in each state demands returns in different forms. Even the data fields from each jurisdiction are different ...

... even a small business like Gilmour’s Comfort Shoes has to produce about fifteen different reports every month ... all accessing the same basic data. (sub. 43, pp. 2, 5)
- Real estate agent regulation — shopping centre owners and managers are subject to this regulation which varies from jurisdiction to jurisdiction. On the one hand,

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the Shopping Centre Council of Australia argue that this is ‘an accident of history’ and unnecessary:

... the ‘consumers’ being protected by this regulation are generally large sophisticated companies which do not need, or want, this legislative protection. Even more absurdly the regulation applies to the agency relationship even when the manager is a related-party entity to the property owner. ... This is nonsensical...

All that regulation does for these owners is impose unnecessary costs that restrict their ability to negotiate efficient arrangements with their agent. (Shopping Centre Council of Australia, sub. 67, p. 45)

On the other hand, the Real Estate Institute of Australia argue that regulation is necessary, given the overall composition of the commercial market and the profile of ownership:

Not all commercial property is high end nor is all of it owned by sophisticated companies and institutions.

Most commercial property, by number, is not valued in the tens of millions of dollars or the hundreds of millions that are involved in major shopping centres ... most ... is owned by small business operators as part of their ongoing business and small ‘mum and dad investors’ as part of their retirement nest egg. As such for the vast majority of commercial property transactions there is a need for regulation and for the sale to be conducted by a qualified commercial property professional. (Real Estate Institute of Australia, sub. DR195, p. 2)

In the Commission’s view, there would appear, *prima facie*, to be a case for examining whether the regulation is too broad in its application and could be better targeted, but these questions are best left to separate review processes.

- Environmental regulation — ANRA (sub. 91 and DR190) and several other participants (for example, NRA, sub. 102) are concerned about the impact of the carbon tax on their cost structures and on consumer demand. ANRA is also concerned about the tendency for governments to mandate the taking of certain environmentally friendly actions, rather than relying on commercial incentives to drive voluntary actions. ‘This is seeing the emergence of ‘green tape’ which is imposing costs on retailers that, in many cases, are not faced by international competitors’ (sub. 91, p. 39). Coles (sub. 79) emphasised the need for a nationally consistent approach to product stewardship regulation, including in relation to plastic bag and beverage container waste.
- Transport regulations:
  - many national retailers have to deal with multiple regulatory regimes within their logistics chains and according to ANRA, ‘compliance costs could be greatly reduced if there was increased consistency across Australia’ (sub. 91, p. 38)

- 
- restrictions on time of transport (local council regulations impose curfews on night time deliveries) and restrictions on type of transport (such as restrictions on trailer size/use of Super B-Doubles or B-Triples) — Woolworths stated that these rules restricts retailers’ freight capacity and operational efficiency and indirectly impact on consumers through product prices and timeliness of deliveries (sub. 110).
  - Paid Parental Leave Scheme — The ANF, whilst supportive of a paid parental leave scheme, considers that employers should not be required to perform the ‘paymaster function’. A similar concern was raised by ACCI which is also concerned about the keeping in touch (KIT) provisions of the scheme.

The potential cost burden and disruption to small business is disproportionately large arising primarily from the administration of payments, maintenance of records, adhering to compliance obligations, reporting requirements and necessary upgrades of payroll and other administrative systems. (ANF, sub. 99, p. 36)

... the Government’s KIT provisions stipulates that any access to work during a period of PPL [paid parental leave] payments, be paid for by the employer in all circumstances. This has resulted in a perverse outcome for some employees who wish to attend during [a] PPL period but requests are not acceded to because of possible payment obligations (and this is despite the employee not wanting to be paid for their brief attendance. ...

[And ACCI recommends that] the *Paid Parental Leave Act 2010* be amended to ensure that it is not obligatory for employees to be paid during a KIT day, unless the employer and employee agree. (ACCI, sub. DR196, p. 32)

- Other inconsistencies in state and territory regulation, not specifically related to retail, include:
  - payroll tax arrangements (Woolworths, sub. 110, NBIA, sub. 1 and Restaurant & Catering Australia, sub. DR193)
  - Workers’ Compensation (Myer, sub. 88 and Restaurant & Catering Australia, sub. DR193) and Public Liability legislation (Myer, sub. 88).

### **13.3 Existing processes for the identification and reform of unnecessary regulatory burdens**

Regulation is a necessary means by which governments can achieve important economic, social and environmental objectives. When regulation is directed at business there will inevitably be some level of compliance burden associated with meeting the regulatory requirements, for example any reporting requirements or from having to alter business processes or activities. But some of this regulatory burden may be unnecessary to the achievement of the outcomes desired by

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governments. Such unnecessary burdens arise where regulation is unduly complex, redundant or where it duplicates the regulations of other jurisdictions or regulatory bodies. Such regulation can lead to excessive financial costs on businesses, change how they operate in undesirable ways and can reduce their flexibility to respond to challenges and opportunities. The overarching objective of regulatory reform is to ensure that regulation is able to achieve its broader objectives without unnecessarily undermining the capacity of businesses to generate productivity growth that underpins higher community living standards.

In February 2007, following the report a year earlier of the Taskforce on Reducing Regulatory Burdens on Business (Banks Taskforce), the Commission was asked to review, over a five-year period, the burdens on business arising from Australian Government regulation. The objective of the review process was to ensure that the stock of regulation is efficient and effective and to identify priority areas where regulation needed to be improved, consolidated or removed.

The Commission's specific task was to identify improvements to regulation that would reduce the burden on business without compromising the underlying policy objectives associated with the regulation. A different sector was to be examined each year and in the second year of the program the Commission examined the burdens on business in the retail sector, as part of its review of the manufacturing and distributive trades sectors (PC 2008a). Some of the specific issues raised in the present inquiry, or similar issues, were examined in that review and/or other annual reviews of regulatory burdens undertaken by the Commission. These include, for example, concerns relating to the sale of tobacco products, food labelling requirements, excessive or duplicative reporting requirements, fortification of bread products, cross jurisdictional differences in OHS and workers' compensation regulation and a lack of consistency in transport rules and environmental regulation.

It was intended that the fifth year of the Annual Review of Regulatory Burdens on Business would consider generic regulation and any regulation missed in earlier reviews. However, in May 2011, the Government asked the Commission instead to assess frameworks and approaches to identifying priority areas for further regulation reform and methods for effectively evaluating reform outcomes, including impacts on administrative and compliance costs for business. The Commission has since released a discussion draft (PC 2011a) and will issue its final report in December.

State and territory governments have direct and primary responsibility for many of the areas of regulation impacting upon the retail sector. The Australian Government, therefore, has little or no ability to directly influence these regulations. However, it does play an important role as a driver of reforms that seek to achieve uniformity, or

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at least greater consistency, in regulation across jurisdictions. In particular, the Australian Government has been involved in the COAG regulatory reform agenda and efforts to move towards a ‘seamless national economy’.

In 2006-07, COAG agreed to the National Reform Agenda (NRA), which aims to — amongst other things — reduce the regulatory burden placed on businesses by all levels of government. COAG also agreed to conduct targeted annual reviews of existing regulation to identify areas where reform would provide significant benefits to business and the community.

In 2008, COAG signed an agreement to deliver a seamless national economy, under which the Australian and state and territory governments committed to reform priority areas, including the acceleration of the implementation of reforms for existing ‘hot spots’. Many of these and other reforms agreed to by COAG are of specific relevance to the retail industry, including those in relation to:

- the uniformity of trade measurement regulation
- national occupational licensing reforms
- consumer protection and product safety regulation
- registration of business names
- the harmonisation of development assessment procedures
- the implementation of nationally uniform OHS regulations
- the harmonisation of payroll tax.

The Commission was also asked by COAG to undertake a series of reviews benchmarking regulatory compliance burdens across jurisdictions in particular areas of regulation. As part of this Performance Benchmarking of Business Regulation project, the Commission has so far finalised reviews of the costs of business registrations (2008), food safety (2010), OHS (2010), and planning and zoning regulation (2011), and is currently undertaking a review of the role of local government as a regulator.

## **13.4 Conclusion**

It is not feasible within the context of this inquiry to undertake a considered examination of the many specific regulatory issues that have been raised. However, the Commission has stated earlier in this report the importance of governments addressing inefficient or ineffective regulations that inhibit the retail industry’s competitiveness, productivity and ultimately its contribution to the Australian

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economy. One aspect of this is ensuring that regulatory compliance burdens imposed on retail businesses are the minimum necessary, consistent with meeting regulatory objectives.

Given the ongoing regulatory review and reform processes of Australian governments, including those under the auspices of COAG, the Commission considers that the specific regulatory burden concerns discussed above are best considered as part of those dedicated processes. Such processes require skilled resources that are in short supply. Therefore, it is important that there be appropriate prioritisation and sequencing of review and reform efforts.

In considering the case for change in any of the specific areas identified in this chapter, it is essential that the costs and benefits of reform options are carefully weighed, including the impacts on all stakeholder groups, not just those businesses directly affected. As always, the objective must be to ensure that changes enhance the welfare of the community as a whole.

Ensuring the quality of the flow of new regulation is also very important. The above concerns about processes for developing regulation — such as lack of consultation, inadequate consideration of alternative options and a failure to demonstrate net benefits — suggest that there may be scope for improvements in the application of RIS processes at the time new regulatory proposals or amendments are being considered. The 2012 COAG benchmarking study of RIS processes provides one opportunity to consider how such processes might be improved.

RECOMMENDATION 13.1

***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.***



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# APPENDIXES



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# A Consultation

The Commission received the terms of reference for this inquiry on 3 February 2011. Notices were then placed in the press and on the Commission's website inviting public participation. Information about the inquiry was circulated to parties identified as likely to have an interest. The Commission released an issues paper on 31 March to assist inquiry participants in preparing their submissions.

The Commission has conducted informal consultations and meetings with government departments and agencies, industry, a consumer organisation, and businesses. As well the Commission held a roundtable in Canberra. Public hearings were held in Melbourne and Sydney following the release of a draft report. The Commission received 239 submissions during the inquiry — 129 submissions were received prior to the release of the draft report on 4 August 2011 and a further 110 submissions were received in response to the draft report. Those submissions received following the release of the draft report contain the prefix 'DR'. All submissions are listed in table A.1.

This appendix also lists those involved in consultations through:

- visits and meetings (table A.2)
- roundtable (table A.3)
- public hearings (table A.4, A.5, A.6 and A.7)

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**Table A.1 Submissions received**

<i>Participant</i>	<i>Submission no.</i>
Abicus Fashion & Music	92
Accord Australasia Limited	75
Adairs Retail Group	129
Affat, Gerry (Vic)	12
Aldi Stores	25
AMP Capital Shopping Centres	DR178
APESMA	DR235
Arc Centre of Excellence for Creative Industries and Innovation	DR179
Aspley Bike Hub	DR207
Australasian Association of Convenience Stores	DR146
Australia Post *	86, 120, DR192
Australian Automotive Aftermarket Association	38
Australian Bureau of Statistics	DR164
Australian Chamber of Commerce and Industry	DR196
Australian Council of Trade Unions	100, DR180
Australian Dental Industry Association	78, DR142
Australian Lease & Property Consultants Pty Ltd	31, 39
Australian Music Association	68
Australian National Retailers Association	91, DR190, DR225
Australian Newsagents' Federation	99
Australian Retailers Association	71, DR162
Australian Sporting Goods Association	49
Australian Toy Association	84, DR166
Ayers, Victor	DR173
Back Bone BMX	54
Bambridge, Paul	DR239
BB Retail Capital	128
Bennett, S	20, DR147
Bernacki, John	DR208, DR232
Bicycle Industries Australia Ltd	53, DR155
Blackman Bicycle Services Pty Ltd	52
Blundy, Neil	50
Boating Industries Alliance of Australia	97

(Continued next page)

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**Table A.1 continued**

<i>Participant</i>	<i>Submission no.</i>
Boltjes, Pauline	DR150
Bras N Things	122
Buerckner, Joanne	DR151
Bulky Goods Retailers Association	109, DR212
Burgess, Kathleen	DR224
Business SA	DR174
Butterworth, Steve	DR130
Callaghan, Jessie	DR144
Campbell, Bruce	DR138
Charalambous, Andrew	96
Choice	82
City of Melbourne	83
City of Sydney	DR219
Classique on Brook	37
Coles	79
Colonial First State Property Management Pty Ltd	73
Colony BMX Pty Ltd	58, DR169
Colyer, Ben	29
Conference of Asia Pacific Express Carriers (Australia) Limited	90, DR156
Cook, Noel	DR153
Council of Small Business Organisations of Australia	74
Creaney, Julie	DR231
Crellin, Matt	108
DCK Australia	117
Martin, Denise	DR204
Department of Planning and Infrastructure (NSW)	114, DR189
Department of Resources, Energy and Tourism	DR210
Di Giulio, Carlo	6
Direct Selling Association of Australia	95
Dite, Chris et al. (Joint Submission)	DR194
Drummond Golf*	93

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(Continued next page)

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**Table A.1 continued**

<i>Participant</i>	<i>Submission no.</i>
eBay Australia and New Zealand Pty Ltd	101, DR165
Eltham Valley Pantry	9
Elwell, Derek	15
Encel, Alex	DR209
Ezibuy	87
Fair Imports Alliance	47, DR171
Fashion Distributors Association of Australia	DR184
Flannigan, Nigel – Uni of Melbourne	DR159
Fleming, Peter	14
ForTheRiders	55, DR158
Frontline Hobbies	19, DR167
Geisler, Leon	DR238
Gilmour's Pty Ltd	43
Golding, Christine	DR202
Golds Books	DR206
Gonzalez, Gonzalo	DR226
Google Australia Pty Ltd	DR199
Grasso, Ross	DR213
Gusto Clothing	104
Hagemeyer Brands Australia Pty Ltd	61
Hawke, Matthew	115
Hawkins, Ann	DR152
Hearsum, Edward	DR227
Hennessy, Michael	23
Hibbett, Gregory	116
Hood, Rosanne	DR133
Hrelja, Alex	DR132
Hutton, Margaret-Anne	DR161
Hyperdome Bike Hub	36
ICOMP Australia Secretariat	DR215
Ikonink Pty Ltd	45
Initiative for a Competitive Online Marketplace	42
Institute of Chartered Accountants in Australia	98

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**Table A.1 continued**

<i>Participant</i>	<i>Submission no.</i>
Institute of Public Affairs	112
International Dynamics	26
Jewellers Association of Australia	65
Johnson, Mike	DR140
Josem Consulting	113
Kerr, Rhonda	107
Kingsel, Geoff	69
KWT Nominees Pty Ltd	76
Lal, Arumina	121
Lanyi, Gustav	DR137
Lifeline Harbour to Hawkesbury	2
Lindysgoodies.com	24
Link International	63
Loring, Paul	7
Lovisa Pty Ltd	118
MacLaurin, Michael	10
Mainly BMX	56
Margetts, Dee	60
Martin, Denise	DR204
McInnes, Marion	DR141
McNally, Michael	DR149
McPherson, Peter	DR168
Meister, Elizabeth	DR234
ModelFXs.com Pty Ltd	28
Moore, Roger	11
Mortimer, Bradley	3
Morton, Kelvin	DR131
Motor Trades Association Queensland	46
Mountain Equipment	DR160
Mur Thai Food Co Pty Ltd	DR237
Myer Holdings Limited	88
Name Withheld	108
Name Withheld	DR125

(Continued next page)

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**Table A.1 continued**

<i>Participant</i>	<i>Submission no.</i>
Name Withheld	DR177
National Association of Retail Grocers of Australia	DR124, DR191
National Baking Industry Association	1
National Retail Association Limited	8, 102, DR126, DR188
New Zealand Retailers Association	66, DR176
Olsen, Lorraine	DR214
Out'N'About	4
ParcelPoint	DR201
Paul's Warehouse	DR228
Pharmacy Guild of Australia	72, DR181
Phillips, Jeffery	85
Photo Imaging Council of Australia	27
Photo Marketing Association	40
Popham, Rodney	DR163
Post Office Agents Association of Australia	127
Powerslide Racing	70
Prysten, Peter	17
Qiao, Chao	DR139
Queensland Consumers Association	DR222
Rae, Kenneth	DR148
Rbate	21
Real Estate Institute of Australia	DR195
Red Herring Surf	41
RED Group Retail	89
Renegade Cycles	34
Restaurant and Catering Australia	DR193
Retail Cycle Traders Australia	57
Retail Guild of Australia Inc	DR236
Retail Traders' Association of Western Australia	80
Rickard, Diana	DR135
Ridgeway, Barrie *	DR187
Riley, Dr Joellen	DR154

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**Table A.1 continued**

<i>Participant</i>	<i>Submission no.</i>
Roberts, Patricia	DR198
Robinson, James	5
Rolles, Irene	DR157
Sacred Ride Jindabyne	44, DR200
SCV Bicycle Imports	30
Service Skills Australia	48, DR182
Shop, Distributive and Allied Employees' Association	18, DR183*, DR223
Shopping Centre Council of Australia	67, 106, DR186
Sichter, Jessica et al. (Joint Submission)	DR175
Simpson, Chris	94
Slam Factory	33
Smbtelnet, Sepp	DR230
Sporting Edge Australia	51
Stapleton, Marian	DR218
Star Audio Visual Association of Australia	13
Stephens, Matthew	DR229
Stephens, Shaun	DR134
Stockland	105, DR203
Strictly BMX	35
Submissions from individuals which have been forwarded by the ACTU	DR211
Swainston, John	22
Target Australia Pty Ltd	64
The Association of Professional Engineers, Scientists & Managers, Australia	235
The Conference of Asia Pacific Express Carriers (Australia) Limited	90
Tourism and Transport Forum	111, DR216
Tran Phan, Richard	DR170
Tyro Payments Limited	62
Unions WA	DR185
United Voice	DR197, DR221
Urban Taskforce	81, DR233
USA Shopping Affair	16
Victorian Employers' Chamber of Commerce and Industry	DR217
Virago, Fabienne`	DR143

(Continued next page)

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**Table A.1 continued**

<i>Participant</i>	<i>Submission no.</i>
Visa AP (Australia) Pty Limited	77, 123
W Lawyers	DR220
Waldron, Jennifer	DR145
Walter, Horst	DR136
Westfield Limited	103
Whitely, Martin	119
Wholesale Diving Supplies Pty Ltd	59
Woolworths Limited	110
Yarra Valley Cycles	32

\* Contains confidential material.

**Table A.2 Visits and meetings**

<i>Participant</i>
Aldi Stores
Alphinity
Appliances Online
Australia Post
Australian Centre for Retail Studies
Australian Council of Trade Unions
Australian Government:
• Australian Competition and Consumer Commission
• Australian Customs and Border Protection Service
• Department of Education, Employment and Workplace Relations
• Department of Broadband, Communications and the Digital Economy
• The Treasury
Australian National Retailers Association
Australian Retailers Association
Bunnings
Canada Border Services Agency (teleconference)
Choice
Citigroup
Coles

(Continued next page)

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**Table A.2 continued**

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**Participant**

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Colonial

Conference of Asia Pacific Express Carriers (Australia) Inc.

Council of Small Business Organisations of Australia

David Jones

DealsDirect

DHL Express (Australia) Pty Ltd

eBay Australia

Fair Imports Alliance

Goldman Sachs

Google Australia Pty Ltd

Grays Online

Harvey Norman

JB Hi Fi

KPMG

Macquarie Securities (Australia) Limited

Morgan Stanley

Myer Holdings Limited

National Retail Association Limited

Paul's Warehouse

PayPal

Platypus Asset Management

PricewaterhouseCoopers

Property Council of Australia

Shopping Centre Council of Australia

Sigma

UBS

W Lawyers

Westfield Limited

Woolworths Limited

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**Table A.3 Roundtable – Canberra – 5 July 2011**

Processing of low value international mail parcels

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*Participant*

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Australia Post

Australian Customs and Border Protection Service

Department of Broadband, Communications and the Digital Economy

The Treasury

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**Table A.4 Public Hearings – Melbourne – 5 September 2011**

<i>Participant</i>	<i>Transcript pages</i>
Australian Retailers Association	3 - 18
Shop Distributive and Allied Employees' Association	19 - 35
Australian Council of Trade Unions	36 - 56
National Retail Association Limited	57 - 81
Australian Sporting Goods Association / Fair Imports Alliance	82 - 97
Lindysgoodies.com	98 - 116

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**Table A.5 Public Hearings – Melbourne – 6 September 2011**

<i>Participant</i>	<i>Transcript pages</i>
Post Office Agents Association	119 - 132
Bicycle Industries Australia Bicycle Superstore Retail Bicycles Australia	133 - 151
Gusto Clothing	152 - 160
Star Audio Visual Association of Australia	161 - 172
International Dynamics	173 - 183
eBay	184 - 200

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**Table A.6 Public Hearings – Sydney – 12 September 2011**

<i>Participant</i>	<i>Transcript pages</i>
Shopping Centre Council of Australia	201 - 214
Aldi Stores	215 - 230
ParcelPoint	231 - 234
Snow Sports Industries Australia/Fair Imports Alliance	235 - 249
Australian National Retailers Association	250 - 267
Maxwell Miles	268 - 276
Choice	277 - 291

**Table A.7 Public Hearings – Sydney – 13 September 2011**

<i>Participant</i>	<i>Transcript pages</i>
Australian Dental Industry Association	295 - 304
Service Skills Australia	305 - 312
National Association of Retail Grocers of Australia	313 - 342
Frontline Hobbies	343 - 358
John Swainston	359 - 369
United Voice	370 - 382
Restaurant and Catering Australia	383 - 393
International Fashion Group	394 - 399



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## B Retail tenancy legislative activity by state

A number of jurisdictions have made progress with implementing certain recommendations from the Commission's 2008 retail tenancy report beyond the COAG reform activity. These include reforms to improve transparency and accessibility of lease information in the retail tenancy market and to improve tenancy market information.

New South Wales, Western Australia and South Australia, following Victoria's lead, are also in the process of establishing a Small Business Commissioner to assist with the resolution of retail tenancy disputes.

At the same time, some recent retail tenancy reform undertaken by the South Australian Government and proposed by the Western Australian Government appears inconsistent with the Commission's previous 2008 recommendations (see box 9.3 in chapter 9).

Recent and prospective state government legislative activity is outlined below.

### **B.1 New South Wales**

The New South Wales Government has undertaken some reforms in response to the Commission's 2008 recommendations to improve transparency and accessibility of lease information in the retail tenancy market. Consistent with recommendation 1(a) in box 9.3, it has developed a retail tenancy kit which provides information to all retail tenants in plain English about key lease terms, including what to look for and what to ask during tenancy negotiations. In addition, consistent with recommendation 1(b) in box 9.3, it also provides a phone hotline for all tenants, landlords and advisers to call when seeking assistance and advice on all retail tenancy matters.

To improve access to tenancy market information, the New South Wales Government already provides for the lodgement of leases with the NSW Land and Property Management Authority — consistent with recommendation 2 in box 9.3.

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Finally, the recently elected New South Wales Government has also committed to appoint a Small Business Commissioner as part of its Small Business Action Plan (NSW Liberals & Nationals 2011). The Commissioner's role would include:

- advocating for the small and medium enterprise sector
- providing a central point where small business concerns about unfair market practices can be addressed in a low cost and timely manner
- resolving disputes between small businesses and government agencies
- ensuring the impact on small businesses is fully considered in the introduction of any new regulations.

This initiative, if implemented, would be consistent with recommendation 1(b) of the Commission's 2008 report (box 9.3).

## **B.2 Western Australia**

The Western Australian Government is currently progressing amendments to the *Commercial Tenancy (Retail Shops) Agreement Act 1985*. The Commercial Retail Tenancy (Retail Shops) Agreement Amendment Bill 2011 was introduced into the Western Australian Parliament on 16 March 2011 and it is anticipated that it will be passed this year.

According to the Explanatory Memorandum of the Bill, it contains a number of amendments which aim to:

- allow tenants to make more informed leasing decisions by requiring landlords to include additional information in the disclosure statements provided to tenants (including options to renew, 'hidden' leasing costs and trade restrictions)
- enhance security of tenure by protecting the rights of tenants with respect to options to renew leases and also during shopping centre redevelopments or relocations
- improve the negotiating power of tenants by prohibiting landlords from passing on certain legal fees to tenants associated with preparing and negotiating the lease
- assist in the preparation of more consistent and equitable rent reviews by requiring landlords and tenants to supply valuers with relevant leasing information (such as information about retail shops in the same building or retail shopping centre)

- 
- prohibit misleading and deceptive conduct and give the State Administrative Tribunal the jurisdiction to hear claims in relation to misleading and deceptive conduct (Western Australian Government 2011a).

Some of these amendments appear to be inconsistent with the spirit and intent of the Commission's 2008 recommendations. They may reduce the incentive for businesses to enter negotiations, reduce flexibility in setting rents and inhibit the allocation of retail space to those tenants who value it most. It would also appear that compliance and administrative costs, particularly for landlords, may increase, without necessarily delivering significant benefits to tenants.

Further legislative activity in Western Australia includes the introduction of the Small Business and Retail Shop Legislation Amendment Bill 2011, which aims to create a Small Business Commissioner for Western Australia. The Commissioner will perform advisory and mediation functions in relation to retail tenancy matters and will have an important alternative dispute resolution function in retail tenancy disputes, but it will not have the power to make a determination. This power will continue to be vested in the State Administrative Tribunal. This proposal, if implemented, could be viewed as fulfilling, at least partially, recommendation 1(b) of the Commission's 2008 report (box 9.3).

According to the Explanatory Memorandum for this Bill, the intent of the proposed legislation is to:

- encourage the fair treatment of small businesses in their commercial dealings with other businesses and government bodies
- provide support for small businesses during the transition to a more deregulated retail trading environment
- reduce the vulnerability of small businesses to unfair market practices
- reduce the frequency and cost of disputes involving small businesses (Western Australian Government 2011b).

In addition, the Western Australian Government is also examining ways to increase transparency of lease information in the market. One of the options that it will be considering is the creation of a publicly accessible database of lease information (managed by a government authority) — the information included on the database would be drawn from summaries of key lease details lodged by the parties to the lease.

The Western Australian Government is still in the early stages of consultation and policy development in relation to this issue. This initiative, if implemented, would be broadly consistent with recommendation 2 (box 9.3) to improve access to

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tenancy market information. While the Commission recommended voluntary lodgement of lease information by the contracting parties, the Western Australian Government's proposal is likely to be mandatory in nature (Western Australian Government, pers. comm., 10 June 2011).

### **B.3 South Australia**

The South Australian Government has not made any legislative changes in response to the recommendations of the Commission's 2008 report. However, it has made a number of minor changes that were included in the Retail and Commercial Leases Regulations 2010. Perhaps the most significant of these was the increase in the rent threshold associated with the application of the *Retail and Commercial Leases Act 1995 (SA)*.

As small retail businesses are considered most likely to be at a disadvantage in terms of access to information and negotiating power in lease negotiations, all jurisdictions have sought to define a retail business for the purpose of the legislation and the threshold needed to define a 'small business'. South Australia has a value-based limit. Under the previous regulation, the Act only applied to premises where the rent did not exceed \$250 000 per annum. The new regulation, which came into operation on 4 April 2011, increases the rent threshold to \$400 000. This means that leases for which annual rent payable is between \$250 000 and \$400 000, which previously were excluded from the application of the Act, will now fall within its scope. This change would appear to be inconsistent with the thrust of the Commission's 2008 report, which focused on avoiding more stringent and prescriptive regulation and having a pause in legislative change as a pre-cursor to greater self-regulation in the retail tenancies market.

In addition, like the New South Wales and Western Australian Governments, the South Australian Government is in the process of establishing an office for the Small Business Commissioner. One of the Commissioner's key roles will be mediating retail tenancy disputes between small businesses and landlords (South Australian Government 2010).

### **B.4 Queensland**

The Queensland Government is currently conducting a statutory review of the *Retail Shop Leases Act 1994*. The review will incorporate consideration of the recommendations from the Commission's 2008 report that may be addressed through legislation. The review is to be completed by June 2012.

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# C Wages and earnings outcomes and trends

## C.1 Wages and earnings

Employees in the retail industry earn less on average than employees in most other industries, reflecting the low average skill level of retail employees. In February 2011, average weekly earnings (AWE) for all retail employees (\$614.00 per week) were 61 per cent of the average across all industries.<sup>1</sup> This outcome is strongly influenced by the high proportion of retail employees who are paid junior rates of pay and/or work part time. However, even among full time adult employees, average weekly ordinary-time earnings in retail are only about three-quarters of the average across all industries (with this ratio slightly lower for male employees and slightly higher for female employees) (ABS 2011b).

Information on average hourly earnings of full time adult employees in the retail industry and the equivalent across all industries is provided in table C.1.

**Table C.1 Average hourly cash earnings, full time non-managerial adult employees, May 2010**

	<i>Ordinary time</i> <sup>a</sup>	<i>Overtime</i> <sup>b</sup>	<i>Total</i>
	\$	\$	\$
Total Retail trade	24.20	32.30	24.40
All industries	31.80	42.30	32.20

<sup>a</sup> Ordinary time earnings relates to payment for award, standard or agreed hours of work, including allowances, penalty payments, payment by measured result, regular and frequent bonuses and commissions (where a retainer/wage/salary is also paid). <sup>b</sup> Overtime earnings relates to payment for hours in excess of award, standard or agreed hours of work.

Source: ABS (*Employee Earnings and Hours*, Cat. no. 6306.0).

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<sup>1</sup> The general approach in this report to retail data coverage was described in chapter 1. However, in this appendix, unless otherwise stated, data for retail *include* motor vehicles and motor vehicle parts and all fuel retailing.

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## Earnings by method of setting pay

Retail employees on individual arrangements earned more than twice as much on average than employees on awards (table C.2), suggesting that individual pay-setting arrangements have mainly been for managerial and other more senior staff. Unlike the pattern observed in nearly all other industries, on average retail employees who are paid award rates of pay appear to earn more than employees who have the main part of their pay set by a collective agreement. However, this might largely be explained by compositional differences between the two groups of employees — this could include for instance, differences in the relative proportions of juniors, casual and part time employees.

The difference between average weekly earnings in the retail industry and all industries is also partly due to the much lower number of average hours worked by retail employees and the higher incidence of junior rates of pay. When the distributions of adult hourly wages are compared, median hourly earnings for award-reliant adult employees in retail was only slightly lower than the median hourly earnings for all award-reliant adult employees (Pech et al. 2009, based on ABS *Employee Earnings and Hours*, May 2006, Cat. no. 6306.0, unpublished data).

**Table C.2 Earnings by method of setting pay, May 2010**

Average weekly total cash earnings

	<i>Award only</i>	<i>Collective agreement<sup>a</sup></i>	<i>Individual arrangement<sup>b</sup></i>	<i>All methods of setting pay</i>
	\$	\$	\$	\$
Retail trade	460.70	416.00	925.20	608.80
All industries	520.00	1050.60	1146.10	1010.30

<sup>a</sup> Includes registered and unregistered collective agreements. <sup>b</sup> Includes registered and unregistered individual arrangements.

Source: ABS (*Employee Earnings and Hours*, Cat. no. 6306.0).

## C.2 Wages growth

Over the 12 year period from June 1998 (the introduction of the ABS Wage Price Index) to June 2010, wage growth (as measured by the growth in total hourly rates of pay excluding bonuses) has been lower in the retail industry than overall wage growth (that is, across all industries). Average annualised growth in retail wages over the period was just over 3.1 per cent, compared with 3.6 per cent across all industries.

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A similar pattern is evident in the more recent data. Over the five years to the June quarter 2010, average annualised growth in retail wages was 3.4 per cent for the retail industry and 3.8 per cent for all industries, and in the 12 months to the March quarter 2011, retail wages grew by 3.3 per cent compared to growth of 3.9 per cent for all industries (ABS 2011f).

Average weekly ordinary time earnings (AWOTE) for full time adult employees in the retail industry increased, in the 12 months to February 2011, by only 0.7 per cent. This was less than one-fifth of the growth rate for all industries (3.8 per cent). For the five and ten year periods ended February 2011, AWOTE in the retail industry grew at an annualised rate of 3.5 and 4.1 per cent, compared with 4.8 per cent for all industries in both periods (ABS 2011b).

Differences between the growth in the wage price index and the AWOTE measure can be the result of changes in the quality or composition of labour, for example, the skill level of the workforce. The wage price index total hourly rates of pay measure is designed to measure changes in wages for a given quantity and quality/composition of labour, while changes in average weekly earnings are affected by both the number of hours worked and the quality/composition of the workforce.

In recent years, average wage increases negotiated under enterprise agreements in the retail industry have also been lower than the average across all industries. Data from the Department of Education, Employment and Workplace Relations (DEEWR) indicate that over the four quarters to September 2010, average annualised wage increases (AAWI) per employee in retail ranged between 3.4 and 3.5 per cent, compared with uniform increases in each quarter, across all industries, of 4.1 per cent.<sup>2</sup> This continues a longer term trend. Since the June quarter 2005, the retail AAWI has been between 0.5 and 0.7 per cent lower than the all industries figure (DEEWR Workplace Agreements Database).

Thus, using a range of measures, growth in retail industry wages and earnings has consistently been lower than the average for all industries.

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<sup>2</sup> AAWIs for all agreements current at the end of each quarter. Estimates of AAWI generally exclude increases paid in the form of conditional performance pay, one-off bonuses, profit sharing or share acquisition, as these data cannot readily be either quantified or annualised.

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### C.3 International comparisons of labour costs

Several submissions compared Australia's wage costs to those overseas, for example, in the United States and the United Kingdom. The following are examples of comments in submissions:

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. (Bicycle Industries Australia Ltd, sub. 53, p. 13)

The minimum wage for all workers in Australia is one of the highest in the world, and is 110% higher than the United States. The prices of goods in Australia are increased by higher wages at all points of the supply chain, not just with retail employees. (Westfield, sub. 103, p. 22)

The focus in these submissions was on Australia's minimum wages. In terms of basic minimum wage rates, Australia's hourly minimum wage is clearly high by comparison with other developed countries, whether expressed as a percentage of median (OECD 2010) or average wages (ILO 2008), or when converted to a common currency using nominal exchange rates or purchasing power parity exchange rates (AFPC 2009).

However, comparisons of minimum wages provide no real insight into relative retail industry labour costs in different countries. While retail employees around the world are typically relatively low paid, most are likely to receive wages that are higher than national minimum wage levels. The Commission notes, for example, that for the financial year 2009-10, the average hourly wage for all retail employees in the United States, including commissions, was US\$12.94 (BLS 2011), compared to the Federal minimum wage of US\$7.25 (U.S. Department of Labor 2011).<sup>3</sup>

Also, when considering comparative *labour costs* faced by retail firms, the quality and composition of the workforce (including the proportion on higher classifications) must be taken into account.

Researchers at Morgan Stanley, based on analysis of hourly rates of pay for employees of selected listed retailers in Australia, the United States and the United Kingdom, for the financial year 2009-10, estimated that total labour rates were on average 27 per cent lower in the United States and 29 per cent lower in the United Kingdom than in Australia (Kierath and Wang 2011). These estimates are not

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<sup>3</sup> Wages include: base rate; incentive pay, including commissions and production bonuses; cost-of-living allowances; guaranteed pay; hazardous-duty pay; and tips. Excluded are overtime pay, severance pay, shift differentials, non-production bonuses, employer cost for supplementary benefits, and tuition reimbursements.

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necessarily reflective of labour cost differences in retail more generally. This is because they are for selected listed (typically larger) retailers only and, although based on company disclosure where available, in other cases they are based on certain assumptions, including about labour costs as a proportion of sales and hours worked.

The total cost of labour to a retail business comprises — in addition to base wages — 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).

Some submissions particularly emphasised the importance, when making international labour cost comparisons, of taking into account penalty rates. While the ACTU claim that penalty rates in Australia are moderate by international standards (trans. p. 42), other participants consider that the penalty rates employers in the Australian retail industry are required to pay are high in comparison with many other countries. DCK Australia Pty Ltd, for example, stated:

In USA and across most of Asia, stores are open until 10-11pm every night and there are no penalty rates for working night shifts or weekends. (sub. 117, p. 2)

The Commission has undertaken a comparison of compensation for work on rest days and public holidays in selected OECD countries (table C.3). Some countries such as Finland and France have relatively generous compensation provisions. Relative to some other countries, penalty rates are higher in Australia. Penalty rates do not apply at all in retail in most states in the United States. In many other countries, such as the United Kingdom, statutory requirements are for compensation by way of leave in lieu, rather than penalty rates.

Using a broad measure of labour costs, the Commission has compared hourly labour costs in Australia with those in a number of European countries as well as the United States. The information presented in table C.4 is for the financial year 2007-08 which was the latest year for which consistent data were available for the retail sector. The figures, which have been converted to constant Australian dollar equivalents and also to US dollar PPP equivalents to adjust for relative purchasing power, suggest that at that time total hourly labour costs in Australian retail were low by comparison with many other developed countries.

**Table C.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).
Austria	Rest period must include Sunday and must begin at the latest on Saturday at 1.00 pm. Time off in lieu for working in rest period must be granted within the same calendar week. Additional pay for work on public holidays unless time off in lieu is granted.
Belgium	Employees working on a Sunday must receive a day off in lieu within 6 days. If the work was in excess of 4 hours on the Sunday, a whole day in lieu is to be granted. For work on Sunday of less than 4 hours a half day in lieu is to be granted. Compensation for work on public holidays is treated the same as for Sunday work.
Canada	Work on a public holiday attracts a loading of 50 per cent.
Finland	Work on Sunday attracts a 100 per cent loading.
France	Payment for work on Sunday can be between the normal rate and up to double the normal rate and 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 of no less than 25 per cent and no more than 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.
Switzerland	Rest period is Saturday 11.00 pm to Sunday 11.00 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 for 2009. 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.

*Source:* General Retail Industry Award 2010; ILO Travail Database (<http://www.ilo.org/dyn/travail/travmain.section>, accessed 13,14 October 2011); ACTU ( sub. DR180).

**Table C.4 Total hourly labour costs<sup>a</sup> for retail trade, 2007-08<sup>b</sup>**

	Local currency	\$AUD <sup>c</sup>	\$US PPP <sup>d</sup>
<i>Based on Eurostat data:</i>			
France	21.80	35.74	24.57
Germany	19.90	32.63	24.48
Italy	18.79	30.81	23.86
United Kingdom	14.63	32.66	22.88
Netherlands	18.74	30.73	22.16
Finland	20.24	33.19	22.01
Austria	18.32	30.04	21.50
Ireland	17.61	28.87	18.54
Spain	12.43	20.38	17.28
Greece	11.61	19.04	16.56
<i>Based on National Statistical Agency data:</i>			
United States <sup>e</sup>	16.47	18.36	16.47
Australia <sup>f</sup>	18.47	18.47	12.49

<sup>a</sup> Data shown are the total labour costs for all firms, except for France, Germany, Italy, Finland, Austria and Greece, where only data for firms with 10 or more employees were available. Unless otherwise indicated, data are sourced from Eurostat. Total labour costs include compensation of employees (wages and salaries, including bonuses, allowances, commissions, employer's social contributions and vocation-training costs), other expenditures, plus taxes less subsidies. <sup>b</sup> Except for Australia and the US, data exclude retail of motor vehicles and motorcycles and parts. Data for all countries include fuel retailing. <sup>c</sup> Exchange rates used to convert to Australian dollars are the annual average 2008 financial year exchange rates for the Euro, Pound and US dollar. <sup>d</sup> Purchasing power parities (PPPs) are rates of currency conversion that equalise the purchasing power of different currencies by eliminating price level differences across countries. GDP-based PPPs from the OECD have been used. <sup>e</sup> Data for the US are compensation of employees from the Bureau of Labor Statistics which include wages and salaries, plus total benefits, including paid leave, employer contributions to pension and insurance funds and government social insurance. <sup>f</sup> Total labour costs for Australia are from the ABS and include wages and salaries and employers' social contributions. Taxes payable by employer are excluded.

Source: Eurostat (2011); ABS (*Australian System of National Accounts*, Cat. no. 5204; *Labour Force, Australia, Detailed*, Cat. no. 6291.0.55.003; *Balance of Payments and International Investment Position, Australia*, Cat. no. 5302.0); OECD (2011); US Bureau of Labor Statistics (2011).

However, when making international comparisons of the effect of labour costs on retail businesses' cost competitiveness, the relative contribution to output of retail workers in each country should also be taken into account. A retail worker in one country may cost more per hour to employ, but may also be more productive. For this reason 'unit labour costs' — defined as the labour cost (including wages, entitlements and on-costs) as a proportion of a given unit or measure of output — can be a better basis for cross-country comparison.

For the retail industry as a whole, data analysed by the Commission suggests that the cost of compensation of employees as a proportion of the value of retail sales is higher in Australia than both the United States and the United Kingdom (table C.5).

**Table C.5 Ratio of labour compensation to retail sales<sup>a</sup>**

Country	2009	Average
		2002 to 2009
	%	%
Australia	17.9	17.9
United States	13.5	13.8
United Kingdom	12.3	12.7

<sup>a</sup> To the extent possible, the Commission has tried to ensure the industry coverage is comparable between countries. In each case sales of motor vehicles, motorcycles and parts and sales of restaurants, cafes and beverage services are excluded. Fuel retailing is included, except for Australia. Definitions of labour compensation, whilst not identical, do in each case include wages and salaries, overtime payments, commissions, bonuses and employer contributions for employee pension, superannuation or government social insurance, as relevant. Retail sales figures vary in some respects, for example, in their treatment, of sales/goods and services tax.

Source: ABS (*Retail Trade*, Cat. no. 8501.0; *Labour Force, Australia*, Detailed Cat. no. 6291.0.55.003); Office of National Statistics (UK) (*Annual Business Survey 2011*, *Annual Business Inquiry 2010*); US Department of Commerce Bureau of Economic Analysis (*National Income and Product Accounts 2010*); US Census Bureau (*Monthly Retail Trade Report 2011*).

The Commission is aware that there is substantial variation in such ratios across retail sub-sectors and within sub-sectors based on the level of sales or turnover of businesses. One source of disaggregated information is the Australian Taxation Office (ATO) benchmarks for small business. The ATO publishes labour cost as a ratio of turnover for nearly 40 separate retail segments. These ratios vary from less than five per cent at the low end of the business turnover range for a small number of segments through to, in one instance, 28 per cent at the top end of the turnover range. These ratios are not directly comparable with the retail-wide ratio for Australia in table C.5 because, for instance, the measure of labour costs used by the ATO is not as broad.

Citigroup analysis (Citi Investment and Research 2011b) comparing Australian retailers with successful global retailers found that in three categories, for which comparative company data were available, the employee cost to sales ratio for the relevant Australian retail group (across all their divisions) significantly exceeded that for the benchmark global retailer:<sup>4</sup>

- Grocery retail — Coles (Wesfarmers) 12.9 per cent, Woolworths 11.5 per cent, Tesco (UK) 10.9 per cent
- Department stores — David Jones 17.1 per cent, Myer 15.0 per cent, Marks and Spencer (UK) 10.0 per cent
- Specialty clothing — Just Group 20.7 per cent, Zara (Europe) 16.2 per cent.

<sup>4</sup> The figures relate to the 2009 financial year reporting period for the relevant retailer. The figure for Myer was amended after the original research was published by Citi.

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## D Flexibility provisions in enterprise agreements

The table in this appendix reports information on the incidence of certain flexibility provisions in retail enterprise agreements and the average incidence for all industries. The information is sourced from the Department of Education, Employment and Workplace Relations Workplace Agreements Database (WAD). The data has informed the analysis in chapter 11 — Workplace relations regulation.

The WAD is a database on all known enterprise agreements that have operated in the federal workplace relations system since the introduction of the Enterprise Bargaining Principle in October 1991. The WAD covers general details (such as sector, ANZSIC, duration, number of employees covered), wage details (quantum and timing of increases) and employment conditions. Information entered on the WAD is derived from copies of federal agreements that are lodged with Fair Work Australia (FWA) or, formerly, the Workplace Authority or the Australian Industrial Relations Commission.

**Table D.1 Incidence of certain flexibility provisions in retail agreements: 1997, 2000, 2005 and 2010**

Proportion of agreements <sup>a</sup>

<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
Competency-based wage movements (employees are automatically re-classified upon attainment of specified competencies)	**	**	11.8	28.2	8.5	7.8	9.2	5.6
Provides details of quantifiable KPIs	**	**	**	**	0.9	3.8	1.7	4.8
Work organisation/performance indicators — the agreement contains one or more work organisation or performance indicators provisions, e.g. benchmarking, new or revised classification structure, or multi-skilling/flexible deployment of labour	**	**	60.0	82.2	43.6	61.1	28.7	52.5
Performance pay/productivity-related bonuses	2.7	4.8	7.1	7.7	5.1	6.7	6.7	8.9
Contains a specific clause outlining a commitment to raising productivity <sup>b</sup>	**	**	**	**	**	**	16.7	38.6
Annualised salary – the agreement incorporates payments which are additional to the employee’s salary, such as penalty rates, overtime payments and allowances, into an annualised salary	0.0	5.1	5.9	4.0	5.1	6.8	18.2	9.6

<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
Loaded hourly rate – the agreement incorporates both shift penalties and allowances into a higher hourly base rate	4.0	2.0	1.2	2.2	15.4	5.7	6.0	4.6
Allowances (regular payments of amounts in excess of minimum rates of pay) are absorbed or incorporated into base rates of pay	1.3	4.1	4.7	6.9	1.7	20.7	7.7	15.7
Make-up time — the agreement allows employees to take time off from work and, at a later date, make up the lost hours	**	**	21.2	6.8	26.5	6.4	7.7	12.1
Overtime: TOIL at ordinary time rates — the agreement allows employees time off in lieu of paid overtime and the time off in lieu accumulates at a rate of ‘time for time’— that is, one hour off for every one hour worked	17.3	8.5	20.0	10.8	21.4	14.8	14.5	25.4
Overtime: TOIL at penalty rates — the agreement allows employees time off in lieu of paid overtime and the time off in lieu accumulates at a rate greater than ‘time for time’, for example 1.5 hours off for every 1 hour worked	21.3	6.1	37.6	5.8	26.5	6.4	55.9	12.1

<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
No restriction on days of the week during which ordinary hours can be worked. Ordinary hours are the hours during which an employee can expect to be rostered for work	24.0	5.4	41.2	9.5	57.3	23.1	33.4	11.8
Hours averaging — the agreement averages weekly hours of work over an extended period (usually longer than a month)	9.3	4.5	8.2	2.8	11.1	3.6	26.2	12.3
Compressed week — the agreement provides that the hours worked in a day can be increased so that the number of days worked in a week will be less	9.3	1.9	9.4	2.4	2.6	1.5	1.2	2.3
Hours of work may be negotiated — the agreement allows for the employer and employees or union to negotiate the hours that employees will work	5.3	6.8	16.5	16.2	2.6	4.3	75.6	43.1
Hours of work varied by employer after consultation — the agreement provides that management may change employee hours but only after consultation with employees	8.0	5.1	22.4	6.0	0.9	2.9	15.0	30.4
Management may alter hours — the agreement allows management to change the actual hours an employee must work, without consultation	2.7	2.2	7.1	3.2	5.1	2.4	71.3	31.4

<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
Flextime — the agreement gives employees options regarding the distribution (but not the amount) of hours they work	4.0	5.3	3.5	3.8	5.1	4.2	**	**
12 hour shift — the agreement either provides for 12-hour shifts or states that employees can work up to 12 hours in a shift	**	**	7.1	7.5	4.3	28.1	**	**
RDOs may be banked/accrued — the agreement allows employees to work on a rostered day off and ‘save’ the day off for use at a later time. Some agreements allow the accrual of up to five rostered days off which can be taken consecutively at a mutually convenient time. To differentiate from ‘time off in lieu for working on a rostered day off’, the emphasis here is on providing more choice for the employee	26.7	25.0	17.6	38.9	17.1	38.5	5.2	37.7
TOIL for working on an RDO — the agreement allows employees to work on their rostered day off whether by choice or employer compulsion, but in return they receive time off work in the future. To differentiate from ‘banking/accrual of rostered days off’, the emphasis here is on the organisation’s needs	17.3	10.4	9.4	8.0	4.3	4.1	0.7	15.8

<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
RDOs may be varied by mutual agreement — the agreement requires the employer and employee or union to agree to any change in the days that rostered days off are taken	25.3	29.3	12.9	43.6	9.4	40.5	4.7	34.6
Breaks not to interrupt continuity of work — the agreement stipulates that breaks may only be taken in a way that allows for an uninterrupted workflow	**	**	8.2	9.7	11.1	11.2	43.1	35.5
Management may alter break — management may direct employees to delay or shorten their break	**	**	9.4	3.6	12.0	10.2	55.4	20.5
Public holidays may be varied by mutual agreement — the agreement contains provisions allowing the parties (that is, the employer, employee and/or union) to mutually agree to change the day that a public holiday will be taken, or whether or not an employee will work on that day	18.7	4.2	25.9	8.2	21.4	13.1	**	**
Fixed/short-term employment — the agreement contains provisions relating to fixed term employment, short-term employment or temporary employment <sup>c</sup>	**	**	37.6	12.9	41.9	21.7	32.7	31.2

<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
Multi-hire — agreement allows for employees to work under more than one employment type e.g. allows full-time employees to work as casuals	**	**	**	**	**	**	1.2	1.4
Casual employment — the agreement contains one or more casual employment provisions. A casual employee is defined as someone who is not entitled to permanent employment benefits, such as leave, but usually receives an additional loading in lieu of these benefits. Casual employees may work full time or part time and are engaged on a day-by-day basis	74.7	35.5	78.8	68.8	79.5	81.4	97.8	92.6
Provisions allowing casual employees to work up to full time hours	**	**	**	**	**	**	21.9	8.5
Conversion of casual engagement to permanent engagement after a defined period	10.7	5.3	8.2	17.5	19.7	32.9	13.5	17.4
Part-time employment — the agreement contains one or more part-time employment provisions. A part-time employee is defined as a continuing employee who works fewer than full-time hours, and is entitled to permanent employment benefits such as sick leave and annual leave on a pro-rata basis	69.3	16.4	82.4	22.4	84.6	53.4	96.5	64.2

<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
Paid parental leave, return to work on a part-time basis after parental leave, or a right to request flexibility for caring purposes greater than the provisions of the NES	**	**	3.5	7.2	9.4	16.7	5.2	18.2
Training provisions for general staff	41.3	66.7	56.5	79.1	43.6	80.6	63.1	72.7
Training provisions for apprentices and formal trainees	49.3	39.5	47.1	52.4	68.4	64.2	90.3	67.3
Training obligations — the agreement notes the importance of training and/or provides a commitment to training. It may specify employer obligations to provide employees with training and/or may outline the obligation of the employee to participate in training for the benefit of the employer	**	**	28.2	52.5	17.9	57.5	**	**
Recognition of prior learning — the agreement provides for the recognition of prior learning. This is a process whereby an employee's competencies, skills and knowledge are assessed and recognised for the purpose of award classification. This is useful where an employee may not have a formal qualification that identifies their skills, knowledge or competence	1.3	1.5	1.2	20.1	0.0	23.2	0.2	13.1



<i>Provision</i>	<i>1997</i>		<i>2000</i>		<i>2005</i>		<i>2010</i>	
	<i>Retail</i>	<i>All industries</i>						
How training is provided — the agreement provides for training and specifies when and where it is to take place (e.g. on-the-job training or off-the-job training, and training within or outside of normal work hours)	14.7	31.4	18.8	37.0	13.7	47.3	**	**
Training leave — the agreement provides for (paid or unpaid) leave for an employee to attend training. Provisions might relate to obligations on the employer to release an employee for defined training purposes, training obligations of the employee in relation to their attendance and attention to the training, or provisions may be associated with study/examination leave	10.7	26.6	16.5	34.2	12.8	16.3	7.5	21.3
Skills assessment — the agreement allows a review to be taken of employees' skills. Details from the process may be recorded, for example in a skills register	**	**	9.4	27.7	6.0	6.2	**	**
Consultative arrangements — the agreement contains one or more provisions on consultative arrangements (e.g. a joint consultative committee or a specific committee to monitor the agreement)	49.3	64.1	34.1	73.4	23.9	56.9	9.2	44.2

<sup>a</sup> Figures are based on new agreements approved in the applicable year. <sup>b</sup> The collection of this data only commenced from 1 January 2010. Figures are based on 401 retail agreements approved by Fair Work Australia in 2010. <sup>c</sup> 2010 definition also includes seasonal workers. <sup>\*\*</sup> Data unavailable.  
Source: DEEWR Workplace Agreements Database.

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## E The Commission's retail price comparisons

The Commission conducted price comparisons on a select range of identical retail goods across Australian bricks and mortar and online retailers, and international online retailers (table E.1). The table consists of randomly chosen goods, where cost comparisons could be made.

There are a range of goods which Australian consumers can purchase online from international retailers. However, where there was no **identical** offering in an Australian bricks and mortar or online store, comparisons have not been included in the analysis. Such inconsistencies indicate the greater variety of goods available through overseas online shopping, rather than a price advantage. This was the case in particular for many items of apparel and outdoor retail goods.

Goods sold by overseas retailers which would not ship to Australia (because of manufacturer or brand restrictions), were also not included. While there are ways for Australian consumers to bypass this obstacle — for example, through redirect shipping services in the United States which enable consumers to direct their purchase to an American address before having the product shipped to Australia (examples include Shipito.com and MyUS.com) — determining the appropriate weight/size of packages to account for these added shipping and delivery costs in the table would render the comparison potentially unreliable.

Due to time constraints in compiling comparisons and the lack of available identical products for some retailer-types, gaps appear in the table. As well, the prices indicated in the comparison table are not intended to be an exhaustive list, nor necessarily the lowest prices available. This work is for illustrative purposes only, to give an indication of the extent of dispersion in the prices of goods across retailers and retailer-types. No statistical weight should be put on the outcomes from this survey due to the limited number of goods and retailers included. The main drivers of price differences and related issues revealed by this work and other similar surveys are discussed in chapter 6.

Table E.1 Price comparisons of identical goods — an Australian consumer's perspective  
\$AUD

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>			<i>Australian online</i>			<i>International online</i>	
<b>Computer and electronics</b>								
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	
<b>Canon IXUS 105IS digital camera (17/5/11)</b>	176.00	169.95		185.00	188.00	218.90	124.00	
>>>Shipping/postage <sup>c</sup>	na	na		9.90	35.30	14.95	64.00	
<b>&gt;&gt;&gt;Total</b>	<b>176.00</b>	<b>169.95</b>		<b>194.90</b>	<b>223.30</b>	<b>233.85</b>	<b>188.00</b>	
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>
<b>Sony Handycam DCR SR68 (2/6/11)</b>	448.00	436.00		453.75	488.57	491.31	276.00	367.00
>>>Shipping/postage	na	na		9.90	10.00	12.00	86.36	0.00
<b>&gt;&gt;&gt;Total</b>	<b>436.00</b>	<b>436.00</b>		<b>463.65</b>	<b>498.57</b>	<b>503.31</b>	<b>362.36</b>	<b>367.00</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>		<i>C1</i>	
<b>Kodak P725 Digital Photo Frame (31/5/11 – 1/6/11)</b>	77.00	86.85	119.00	85.00	99.00		52.51	
>>>Shipping/postage	na	na	na	12.00	15.00		36.48	
<b>&gt;&gt;&gt;Total</b>	<b>77.00</b>	<b>86.85</b>	<b>119.00</b>	<b>97.00</b>	<b>114.00</b>		<b>88.99</b>	
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>			
<b>Acer Aspire 18" 8950G Notebook (17/5/11)</b>	2498.00	2796.00		2399.95	2723.00			
>>>Shipping/postage	na	na		0.00	0.00			
<b>&gt;&gt;&gt;Total</b>	<b>2498.00</b>	<b>2796.00</b>		<b>2399.95</b>	<b>2723.00</b>			
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>
<b>Nikon Coolpix L23 Digital Camera (17/5/11)</b>	99.00	99.00	99.00	92.00	96.80	96.80	80.00	96.31
>>>Shipping/postage	na	na	na	9.90	9.90	9.90	36.50	19.80
<b>&gt;&gt;&gt;Total</b>	<b>99.00</b>	<b>99.00</b>	<b>99.00</b>	<b>101.90</b>	<b>106.70</b>	<b>106.70</b>	<b>116.50</b>	<b>116.11</b>

Table E.1 (continued)

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>			<i>Australian online</i>			<i>International online</i>		
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	
<b>iPod Dock CD Clock Radio – Sony ICFCD3IP (1/6/11 – 2/6/11)</b>	149.00	149.00	149.00	89.95	113.00	156.50	87.17	99.47	
>>>Shipping/postage <sup>c</sup>	na	na	na	9.95	16.00	9.50	51.57	45.19	
<b>&gt;&gt;&gt;Total</b>	<b>149.00</b>	<b>149.00</b>	<b>149.00</b>	<b>99.90</b>	<b>129.00</b>	<b>166.00</b>	<b>138.74</b>	<b>144.66</b>	
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Sony NEX-5 Digital Camera with 18-55mm SLR Lens (2/6/11)</b>	1097.00	896.00	1046.00	1122.95	789.95	1026.95	598.00	630.00	772.99
>>>Shipping/postage	na	na	na	0.00	9.95	9.95	52.25	47.00	0.00
<b>&gt;&gt;&gt;Total</b>	<b>1097.00</b>	<b>896.00</b>	<b>1046.00</b>	<b>1122.95</b>	<b>799.90</b>	<b>1036.90</b>	<b>650.25</b>	<b>677.00</b>	<b>772.99</b>
<b>Toys and games</b>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Monopoly Revolution Board Game (31/5/11-1/6/11)</b>	69.95	80.00		59.95	59.95	56.16	23.45	21.08	41.69
>>>Shipping/postage	na	na		4.95	13.95	0.00	26.95	38.43	9.19
<b>&gt;&gt;&gt;Total</b>	<b>69.95</b>	<b>80.00</b>		<b>64.90</b>	<b>73.90</b>	<b>56.16</b>	<b>50.40</b>	<b>59.51</b>	<b>50.88</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	
<b>L.A. Noire video game (PS3) (31/5/11)</b>	88.00	88.00	104.99	77.68	56.25	56.50	61.45	38.99	
>>>Shipping/postage	na	na	na	0.00	8.95	8.90	2.99	9.99	
<b>&gt;&gt;&gt;Total</b>	<b>88.00</b>	<b>88.00</b>	<b>104.99</b>	<b>77.68</b>	<b>65.20</b>	<b>65.40</b>	<b>64.44</b>	<b>48.98</b>	
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	
<b>Nerf-N-Strike Vulcan toy (31/5/11 – 1/6/11)</b>	89.99	59.94		65.32	109.99	89.95	66.43	64.75	
>>>Shipping/postage	na	na		0.00	7.95	9.95	44.80	59.79	
<b>&gt;&gt;&gt;Total</b>	<b>89.99</b>	<b>59.94</b>		<b>65.32</b>	<b>117.94</b>	<b>99.90</b>	<b>111.23</b>	<b>124.54</b>	

Table E.1 (continued)

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>			<i>Australian online</i>			<i>International online</i>		
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>			
<b>MATTEL Turbo Glo Buzz Lightyear Deluxe toy (31/5/11)</b>	69.00	79.99		79.00	83.00	79.99			
>>>Shipping/postage <sup>c</sup>	na	na		8.80	6.95	7.95			
<b>&gt;&gt;&gt;Total</b>	<b>69.00</b>	<b>79.99</b>		<b>87.80</b>	<b>89.95</b>	<b>87.94</b>			
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Call Of Duty Black Ops (PS3) (12/7/11)</b>	100.00	74.00	89.00	76.99	56.99	47.75	74.95	29.99	7.65
>>>Shipping/postage	na	na	na	0.00	0.00	8.90	0.00	14.99	14.99
<b>&gt;&gt;&gt;Total</b>	<b>100.00</b>	<b>74.00</b>	<b>89.00</b>	<b>76.99</b>	<b>56.99</b>	<b>56.65</b>	<b>74.95</b>	<b>44.98</b>	<b>22.64</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>The Sims Medieval: Limited Ed. Game (PC) (12/7/11)</b>	98.00	89.00		52.95	45.68	89.95	119.95	29.45	24.49
>>>Shipping/postage	na	na		0.00	0.00	5.95	0.00	9.95	8.99
<b>&gt;&gt;&gt;Total</b>	<b>98.00</b>	<b>89.00</b>		<b>52.95</b>	<b>45.68</b>	<b>95.90</b>	<b>119.95</b>	<b>39.40</b>	<b>33.48</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>		<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Transformers 3 Mechtech Leader Bumblebee (12/7/11)</b>	79.99	65.00	79.00	109.00	94.99		73.62	44.70	74.52
>>>Shipping/postage	na	na	na	0.00	0.00		0.00	22.29	0.00
<b>&gt;&gt;&gt;Total</b>	<b>79.99</b>	<b>65.00</b>	<b>79.00</b>	<b>109.00</b>	<b>94.99</b>		<b>73.62</b>	<b>66.99</b>	<b>74.52</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>			<i>C1</i>		
<b>Barbie I Can Be a Bride Doll Set (12/7/11)</b>	44.64	42.99		89.72			46.59		
>>>Shipping/postage	na	na		19.55			27.64		
<b>&gt;&gt;&gt;Total</b>	<b>44.64</b>	<b>42.99</b>		<b>109.27</b>			<b>74.23</b>		

Table E.1 (continued)

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>		<i>Australian online</i>			<i>International online</i>			
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>		
<b>Razor Ripstik Castorboard</b> (12/7/11)	92.00	99.00	129.00	89.90	99.90	55.88	55.91		
>>>Shipping/postage <sup>c</sup>	na	na	9.95	18.60	18.60	51.40	51.26		
<b>&gt;&gt;&gt;Total</b>	<b>92.00</b>	<b>99.00</b>	<b>138.95</b>	<b>108.50</b>	<b>118.50</b>	<b>107.28</b>	<b>107.17</b>		
<b>Health and beauty</b>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Britney Spears Circus Fantasy</b> <b>100ml</b> (31/5/11)	49.95	67.15	79.00	39.90	39.95	48.50	48.00	33.91	42.39
>>>Shipping/postage	na	na	na	9.95	7.95	4.95	0.00	15.37	8.48
<b>&gt;&gt;&gt;Total</b>	<b>49.95</b>	<b>67.15</b>	<b>79.00</b>	<b>49.85</b>	<b>47.90</b>	<b>53.45</b>	<b>48.00</b>	<b>49.28</b>	<b>50.87</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>		<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Lancome Hypnose Spray 50ml</b> (2/6/11)	116.95	88.40	130.00	73.00	66.00		66.00	52.70	53.75
>>>Shipping/postage	na	na	na	0.00	0.00		0.00	14.84	22.51
<b>&gt;&gt;&gt;Total</b>	<b>116.95</b>	<b>88.40</b>	<b>130.00</b>	<b>73.00</b>	<b>66.00</b>		<b>66.00</b>	<b>67.54</b>	<b>76.26</b>
<i>Retailer</i>	<i>A1</i>			<i>B1</i>	<i>B2</i>		<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Elizabeth Arden Intervene 3-in-1</b> <b>Cleanser Exfoliator Primer</b> <b>150ml/5oz</b> (2/6/11)	48.00			21.99	25.00		19.50	14.95	6.32
>>>Shipping/postage	na			0.00	0.00		0.00	0.00	4.02
<b>&gt;&gt;&gt;Total</b>	<b>48.00</b>			<b>21.99</b>	<b>25.00</b>		<b>19.50</b>	<b>14.95</b>	<b>10.34</b>
<i>Retailer</i>				<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Clinique Full Potential Lips</b> <b>Plump &amp; Shine 4.7ml</b> (2/6/11)				25.00	21.99	26.95	19.50	9.38	7.46
>>>Shipping/postage				0.00	0.00	0.00	0.00	8.40	2.11
<b>&gt;&gt;&gt;Total</b>				<b>25.00</b>	<b>21.99</b>	<b>26.95</b>	<b>19.50</b>	<b>17.78</b>	<b>9.57</b>

Table E.1 (continued)

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>			<i>Australian online</i>			<i>International online</i>		
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>		<i>B1</i>	<i>B2</i>		<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Maybelline Instant Age Rewind Eraser Treatment Foundation</b> (4/6/11 – 5/6/11)	22.00	23.50		12.95	13.95		5.87	6.53	5.59
>>>Shipping/postage <sup>c</sup>	na	na		5.00	4.95		4.62	9.33	12.11
>>>Total	<b>22.00</b>	<b>23.50</b>		<b>17.95</b>	<b>18.90</b>		<b>10.49</b>	<b>15.86</b>	<b>17.70</b>
<b>Books, DVDs and music</b>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Australians: Origins to Eureka (hardcover)</b> (1/6/11)	59.95	59.99	59.99	34.45	42.35	44.35	21.68	33.93	25.88
>>>Shipping/postage	na	na	na	0.00	7.00	6.50	8.43	0.00	8.86
>>>Total	<b>59.95</b>	<b>59.99</b>	<b>59.99</b>	<b>34.45</b>	<b>49.35</b>	<b>50.85</b>	<b>30.11</b>	<b>33.93</b>	<b>34.74</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Born This Way: Lady Gaga album</b> (1/6/11)	17.99	21.99	19.99	21.45	19.90		13.95	11.19	
>>>Shipping/postage	na	na	na	0.00	2.00		0.00	8.99	
>>>Total	<b>17.99</b>	<b>21.99</b>	<b>19.99</b>	<b>21.45</b>	<b>21.90</b>		<b>13.95</b>	<b>20.18</b>	
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>		<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Harry Potter 7 (paperback) Signature ed. UK</b> (18/5/11)	22.95	22.99		20.91	17.00		13.00	13.27	14.41
>>>Shipping/postage	na	na		0.00	7.00		0.00	0.00	0.00
>>>Total	<b>22.95</b>	<b>22.99</b>		<b>20.91</b>	<b>24.00</b>		<b>13.00</b>	<b>13.27</b>	<b>14.41</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>The Oxford Shakespeare: Complete Works (hardcover)</b> (31/5/11)	110.00	54.95	38.95	42.72	42.52	44.40	21.81	24.29	32.38
>>>Shipping/postage	na	na	na	0.00	7.00	6.50	8.42	8.88	13.54
>>>Total	<b>110.00</b>	<b>54.95</b>	<b>38.95</b>	<b>42.72</b>	<b>49.52</b>	<b>50.90</b>	<b>30.23</b>	<b>33.17</b>	<b>45.92</b>

Table E.1 (continued)

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>			<i>Australian online</i>			<i>International online</i>		
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>		<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>		
<b>The Fighter (DVD) (31/5/11)</b>	22.98	24.95		34.95	31.95	24.95	15.44		
>>>Shipping/postage <sup>c</sup>	na	na		0.00	0.00	7.95	7.47		
<b>&gt;&gt;&gt;Total</b>	<b>22.98</b>	<b>24.95</b>		<b>34.95</b>	<b>31.95</b>	<b>32.90</b>	<b>22.91</b>		
<i>Retailer</i>	<i>A1</i>			<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>		
<b>Friends – season 1-10 Complete Collection DVD (Anniv. Ed.) (31/5/11)</b>	190.99			165.00	139.95	139.95	84.77		
>>>Shipping/postage	na			0.00	0.00	0.00	0.00		
<b>&gt;&gt;&gt;Total</b>	<b>190.99</b>			<b>165.00</b>	<b>139.95</b>	<b>139.95</b>	<b>84.77</b>		
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>John Howard: Lazarus Rising (hardcover) AU (1/6/11)</b>	44.99	58.95	59.99	43.99	49.97	50.95	32.78	47.92	58.62
>>>Shipping/postage	na	na	na	0.00	0.00	6.50	8.43	0.00	0.00
<b>&gt;&gt;&gt;Total</b>	<b>44.99</b>	<b>58.95</b>	<b>59.99</b>	<b>43.99</b>	<b>49.97</b>	<b>57.45</b>	<b>41.21</b>	<b>47.92</b>	<b>58.62</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>	<i>B2</i>		<i>C1</i>		
<b>Recurring Dream – Very Best of Crowded House CD (1/6/11)</b>	32.99	14.99		13.51	27.99		9.95		
>>>Shipping/postage	na	na		0.00	2.00		0.00		
<b>&gt;&gt;&gt;Total</b>	<b>32.99</b>	<b>14.99</b>		<b>13.51</b>	<b>29.99</b>		<b>9.95</b>		
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>				
<b>Russell Coight's All Aussie Adventures S1 &amp; S2 (1/6/11)</b>	24.99	19.99	24.97	24.99	23.86				
>>>Shipping/postage	na	na	na	4.99	0.00				
<b>&gt;&gt;&gt;Total</b>	<b>24.99</b>	<b>19.99</b>	<b>24.97</b>	<b>29.98</b>	<b>23.86</b>				

Table E.1 (continued)

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>			<i>Australian online</i>			<i>International online</i>		
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>	<i>A3</i>	<i>B1</i>	<i>B2</i>	<i>B3</i>	<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Roald Dahl's Scrumdidlyumptious Story Collection (paperback) UK (2/6/11)</b>	49.95	49.95	49.95	42.46	44.95	40.00	22.66	33.24	22.65
>>>Shipping/postage <sup>c</sup>	na	na	na	3.50	6.50	6.95	0.00	0.00	13.48
<b>&gt;&gt;&gt;Total</b>	<b>49.95</b>	<b>49.95</b>	<b>49.95</b>	<b>45.96</b>	<b>51.45</b>	<b>46.95</b>	<b>22.66</b>	<b>33.24</b>	<b>36.13</b>
<b>Outdoor and apparel</b>									
<i>Retailer</i>	<i>A1</i>	<i>A2</i>		<i>B1</i>			<i>C1</i>		
<b>Spalding NBA Never Flat Basketball (18/7/11)</b>	74.99	74.99		70.00			87.57		
>>>Shipping/postage	na	na		8.50			7.81		
<b>&gt;&gt;&gt;Total</b>	<b>74.99</b>	<b>74.99</b>		<b>78.50</b>			<b>95.38</b>		
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>A3</i>				<i>C1</i>	<i>C2</i>	
<b>NIKE Dri-Fit Feather Light Hat (18/7/11)</b>	29.99	30.00	30.00				26.30	18.78	
>>>Shipping/postage	na	na	na				12.11	28.89	
<b>&gt;&gt;&gt;Total</b>	<b>29.99</b>	<b>30.00</b>	<b>30.00</b>				<b>38.41</b>	<b>47.67</b>	
<i>Retailer</i>	<i>A1</i>	<i>A2</i>					<i>C1</i>		
<b>Ralph Lauren Men's Polo Shirt (18/7/11)</b>	109.95	109.95					119.88		
>>>Shipping/postage	na	na					0.00		
<b>&gt;&gt;&gt;Total</b>	<b>109.95</b>	<b>109.95</b>					<b>119.88</b>		
<i>Retailer</i>	<i>A1</i>						<i>C1</i>	<i>C2</i>	
<b>Nike Women's Everyday Fit + Trainers (18/7/11)</b>	139.00						89.91	105.00	
>>>Shipping/postage	na						0.00	25.00	
<b>&gt;&gt;&gt;Total</b>	<b>139.00</b>						<b>89.91</b>	<b>130.00</b>	

Table E.1 (continued)

<i>Product<sup>a</sup></i>	<i>Australian bricks and mortar<sup>b</sup></i>		<i>Australian online</i>		<i>International online</i>		
<i>Retailer</i>	<i>A1<sup>d</sup></i>	<i>A2</i>	<i>B1</i>				
<b>Everlast Mens Gym Hoodie</b> (16/8/11)	74.99	74.00	50.00				
>>>Shipping/postage <sup>c</sup>	na	na	9.50				
<b>&gt;&gt;&gt;Total</b>	<b>74.99</b>	<b>74.00</b>	<b>59.50</b>				
<i>Retailer</i>	<i>A1</i>	<i>A2</i>			<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Everlast MMA Sparring Gloves</b> (19/10/11)	74.99	74.99			39.00	28.78	31.22
>>>Shipping/postage	na	na			28.04	17.21	33.82
<b>&gt;&gt;&gt;Total</b>	<b>74.99</b>	<b>74.99</b>			<b>67.04</b>	<b>45.99</b>	<b>65.04</b>
<i>Retailer</i>	<i>A1</i>	<i>A2</i>	<i>B1</i>	<i>B2</i>			
<b>Sherrin Lyrebird Leather AFL football</b> (27/10/11)	39.95	39.99	40.00	35.00			
>>>Shipping/postage	na	na	8.50	12.00			
<b>&gt;&gt;&gt;Total</b>	<b>39.95</b>	<b>39.99</b>	<b>48.50</b>	<b>47.00</b>			
<i>Retailer</i>	<i>A1</i>	<i>A2</i>			<i>C1</i>	<i>C2</i>	<i>C3</i>
<b>Michael Kors MK5300 Watch</b> (27/10/11)	399.00	399.00			294.28	172.27	207.65
>>>Shipping/postage	na	na			16.02	38.08	27.40
<b>&gt;&gt;&gt;Total</b>	<b>399.00</b>	<b>399.00</b>			<b>310.30</b>	<b>210.35</b>	<b>235.05</b>

Table E.1 (continued)

Retailer	A1	A2	C1
<b>EPL Manchester United Men's Home Jersey 2010/2011 – Red (31/10/11)</b>	199.99	199.99	75.72
>>>Shipping/postage	na	na	9.42
<b>&gt;&gt;&gt;Total</b>	<b>199.99</b>	<b>199.99</b>	<b>84.14</b>

<sup>a</sup> Prices of the identical goods from multiple retailers were collected within the same one or two day period. <sup>b</sup> Where the retailer is a multichannel retailer, the price on the online catalogue is assumed to be the same as the price of the good in the bricks and mortar store. <sup>c</sup> All delivery charges are based on the cheapest delivery option available. Prices do not take into account discounts or reductions in shipping costs which may accompany multiple purchases of goods. <sup>d</sup> The table preserves the anonymity of retailers, with the categories reflecting only the different types of retailers (that is, 'A' retailers represent different Australian bricks and mortar retailers and 'B' retailers represent Australian online retailers). Each individual retailer code (for example, A1, A2 etc.) is therefore not unique or representative of a *specific* retailer.

Source: PC Research (2011).

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# F Foreign indirect tax arrangements

## F.1 Foreign arrangements

To inform discussion on the issue of an appropriate LVT, the Commission has examined how mail processing and tax collection systems work in other countries.

### Foreign thresholds

Most other countries have set thresholds below which they do not attempt to collect taxes. The thresholds can vary from around €10 (A\$13) in some European Union (EU) countries to NZ\$400 (A\$308). Hong Kong does not impose any duty or taxes at all on imports. Some countries, such as Turkey and Israel, do not have a threshold, but exempt certain goods. Some examples of threshold levels are set out in table F.1.

### Gift concessions

Many foreign countries have different thresholds for gifts. In the United Kingdom items entering as gifts worth £40 (A\$62) or less are free from duty and import value added tax (VAT), but not excise. Goods entering Switzerland as gifts up to a value of SFr100 (A\$109) are exempt from duty and VAT. Canada exempts the first Can\$60 (A\$57) of the value of a gift. In New Zealand customs charges are not payable on the first NZ\$110 (A\$85) in value of an unsolicited gift and no revenue is collected if the total amount of revenue owing would be less than NZ\$60 (A\$46). During informal discussions with the Commission, it was noted that parcels sent from some businesses to consumers in other countries appeared to be routinely marked as gifts, but that this description was not automatically accepted by foreign customs authorities.

In Australia, prior to 2008, the first \$200 of the value of the gift was duty and GST free. The concession did not include tobacco products in excess of 250 cigarettes or 250 grams of tobacco or alcoholic liquor in excess of one litre. This concession was revoked from 1 October 2008 because its use significantly decreased following the

change to the LVT threshold in 2005, and to remove the inconsistency in the treatment of alcoholic beverages and tobacco (Customs 2008).

**Table F.1 Thresholds in other countries**

<i>Country</i>	<i>Threshold in A\$</i>	<i>Threshold<sup>a</sup></i>
Canada	19	Importer does not have to pay duties and taxes if a parcel is worth Can\$20 (A\$19) or less except for alcohol, tobacco, and, in some circumstances, books, or magazines.
United Kingdom	28 (VAT) 208 (duty)	Consignments valued at £18 (A\$28) (£15 from November 2011) or less are free from import VAT (but not excise duty). Duty is payable if the value of the goods is over £135 (A\$208), although the duty is waived if the amount of duty is less than £9 (A\$14).
Chile	28	US\$30.
Netherlands	30 (VAT) 201 (duty)	No duty or turnover tax on shipments valued at up to €22 (A\$30). No duty on shipments valued at up to €150 (A\$201).
Indonesia	47	US\$50.
Switzerland	68	Import VAT is not collected if the tax would be less than SFr5. This is usually equivalent to a parcel value of SFr 62.
China	72	First Y400 (A\$58) of value for personal postal articles from Hong Kong and Macao is duty free. First Y500 (A\$72) of value for personal postal articles from other places.
Japan	115	¥10,000.
Korea	130	Exempt if the total value of the goods including freight and insurance is less than W150,000 and goods are for personal use.
Malaysia	140	US\$150.
United States	187	US\$200.
Singapore	303	S\$400 based on the value of the goods.
New Zealand	308	GST and duties not collected if they would be less than NZ\$60 (A\$44) in total. The threshold would be NZ\$400, in terms of the value of the goods, if no duty were payable.
Australia	1000	A\$1000.
Hong Kong	Not applicable	No entry threshold limit — imports of any value come in duty and tax free.

<sup>a</sup> Exchange rates as at 31 May 2011. The thresholds quoted often exclude goods such as tobacco and alcohol.

Sources: APEC (2010); NZ Customs (2011); various national customs services.

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## Setting and administering thresholds

The Commission has sought information on how other countries have approached the issue of setting a threshold. However, there is very little public information available. Only the United Kingdom and New Zealand appear to have recently completed a publicly visible review of their thresholds, although the Commission understands that some other countries have also recently reviewed their LVTs, but within Government departments. In considering the appropriate threshold, it appears that some countries emphasise the economic costs and benefits of the threshold, while other countries place more emphasis on equity, law enforcement, or the protection of domestic industries.

In communications with the Commission, the OECD has said that discussions around the issue of ‘low value consignment relief’ are well known to it, but to date the OECD has not been able to bring forward any work on the issue. Similarly, some material on threshold levels has been submitted to an APEC committee. A recent statement indicated that APEC officials had been instructed to:

Identify ways to simplify customs procedures, and reduce costs for importers and exporters, including by developing a plan by November 2011, building on best practices in effect in each of our economies, to ensure wider implementation of commercially useful de minimis values, which exempt low-value importation from revenue collection ... (APEC 2011, p. 1)

The Commission has also sought information about methods of processing international mail parcels. While other countries have different approaches to the process, the initial sorting of international mail parcels in other jurisdictions appears to be a manual process, similar to that used in Australia. New Zealand Customs has observed that:

Customs, like every other customs administration, has to manually risk assess and process a large volume of international parcels post. It is not practicable to assess and collect all possible duty payable in terms of additional staff required or delays to goods clearance. Establishing a de minimis requires judgements over the trade off between integrity of the taxation system and the costs and practicalities of revenue collections. (NZ Customs 2011b, p. 4)

### *European Union*

The thresholds applied by members of the European Union are guided by a Council Directive. It requires member states to exempt goods of a total value not exceeding €10, but allows them to grant exemption for goods valued at between €10 and €22 (EU 2009a). Thresholds within the European Union only affect parcels entering European Union countries from outside the European Union. Duty is not applicable on the movement of goods within the European Union and other arrangements have

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been made to deal with collection of VAT on cross-border transactions. Implementation of the European Union directive is left to individual countries.

In its 2011 Budget, the Government of the United Kingdom announced that it would reduce the level of the threshold in the United Kingdom from £18 to £15 from November 2011. The decision followed concerns that some UK retailers had been taking advantage of the low value consignment relief by selling goods over the internet, VAT-free, from subsidiaries based in Jersey and Guernsey. The estimated cost to the Exchequer of this practice had risen from around £80 million a year to £130 million over the previous five years. In the past, the UK Government was reluctant to tackle the problem by cutting the threshold for imports because of the extra demands this would place on HM Revenue & Customs (HMRC) (House of Commons Library 2011). But more recently, in his budget statement the Chancellor of the Exchequer said that:

And we're going to tackle the exploitation of low value consignment relief that has left our high street music stores fighting a losing battle with warehouses in the Channel Islands. (Osbourne 2011, p. 15)

In a Tax Information and Impact Note outlining the change to the threshold, the low value consignment relief is described as an administrative simplification to reduce the cost for businesses, HMRC, Royal Mail, express carriers and consumers. It said that there are no figures available that indicate how many individual consumers import goods or how they will be affected financially. The one-off and on-going compliance costs for fast parcel operators involved in importing goods to the United Kingdom were considered to be negligible, although no costings were provided. Similarly, no figures were provided on the cost to HMRC, and the impact on the Royal Mail was described as limited (HM Treasury 2011).

The UK Government will revisit the level of the threshold in its next budget if discussions with the European Commission do not produce a workable solution to the problem of the relief being exploited for a purpose for which it was not intended (HM Treasury 2011).

In the United Kingdom, parcels arriving from within the European Union are generally treated as internal mail. For other international mail parcels, Royal Post/Parcelforce is responsible for initially identifying items which might be of interest because of their value or border security issues. If a parcel is valued at above the threshold, HMRC key in to their system data about the parcel, identify the customs code from a simplified schedule of duties and classifications and produce a label and bar code identifying the amount of duty and VAT due on the parcel. Royal Mail/Parcelforce then pays the taxes, enters the parcel into its system and sends the addressee a letter advising them of the taxes due and the Royal Mail/Parcelforce

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clearance fee of £8 (A\$12), or £13.50 (\$A21) for express parcels. The taxes and fees can be paid online, by phone, or over the counter at a Royal Mail/Parcelforce depot before the parcel is delivered. This process usually delays the delivery of a parcel by one or two days unless the consignee is an account holder, in which case the goods are delivered immediately and the account is charged directly.

HMRC also has special arrangements that allow some large overseas traders to charge, collect and pay over to HMRC the import VAT for goods purchased on the internet (box F.1). In some cases the arrangements operate through Memoranda of Understanding (MOU) with customs and postal authorities in the Channel Islands, Hong Kong, Singapore and New Zealand. The Commission understands that pre-paid parcels under the MOUs are segregated from normal mail and the pre-payment checked before they are passed on to Royal Mail for delivery (HMRC 2010).

### *Canada*

In 2009, Canada Post Corporation received 33 million parcels from foreign postal administrations (Canada Post 2010). A similar number of express courier parcels enters Canada each year. The current process for handling postal parcels is highly manual and labour intensive.

Parcels received from outside Canada are sent to a Canada Border Services Agency (CBSA) mail centre where border services officers screen the parcel to decide if any duties and taxes are due. CBSA officers enter the description and value of the goods into its automated system which calculates any duty and taxes owing and prints the information on a label which is attached to the parcel (CBSA 2011b). Canada Post Corporation collects the taxes plus its own customs handling fee of Can\$8.50 (A\$8) during delivery (Canada Post 2011).

#### **Box F.1 Amazon Global Program**

The Amazon Global Program estimates duty, taxes and customs clearance costs on a customer's behalf during checkout. When products are shipped to one of over fifty eligible countries using eligible shipment options, an Import Fees Deposit is collected for the shipment. The funds are used by the carrier or another agent to pay the import fees on the customer's behalf to the appropriate authorities of the destination country.

If the actual import fees (paid by carrier on behalf of the recipient to the customs and tax authorities of the destination country) are less than the Import Fees Deposit collected by Amazon they will refund the difference. If the fees exceed the Import Fees Deposit the purchaser is not charged any extra.

*Source:* Amazon (2011).

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Parcels from Amazon can have taxes pre-paid and are identified by a sticker displaying the Amazon GST registration number (box F.1). Some other online purchases by Canadians from US retailers have taxes and duties paid at the time of purchase and then enter Canada by courier through an expedited delivery system where the courier acts as the importer of record (CBSA 2011b).

This process is now being streamlined. Canada Post is currently undertaking a Postal Transformation Project aimed at transforming their operations by replacing the ageing equipment, buildings and technology to make their operations as efficient as possible (Canada Post 2010). The CBSA and Canada Post are working together to modernize the assessment and processing of international mail to address gaps and introduce technological advances. In 2011-12, the CBSA will begin developing a new information technology system that will address the risk assessment, financial reconciliation and overall enforcement needs of the Postal program. The new system is expected to be completed by December 2013 (CBSA 2011a).

Canada is involved in the Mails Electronic Data Interchange and Customs Integration program (MEDICI) which is being developed by the International Post Corporation (of which Australia Post is a member). The MEDICI program allows participating postal operators to capture and electronically exchange the data needed for each mail item to clear customs and for taxes to be assessed. The data captured are the data required for CN22 or CN23 forms, together with whatever additional information is required for the identification of the postal item. The data is shared with customs authorities and can be used by customs to screen parcels (IPC 2011). Canada Post, Deutsche Post DHL, Royal Mail and the United States Postal Service have been both capturing and sending data, while Le Groupe La Poste, Hong Kong Post and South Africa Post receive data (IPC 2010).

### *New Zealand*

New Zealand has a de minimis under which the New Zealand Customs Service (NZCS) does not charge duty and GST where the total revenue payable on any one importation (except for alcohol and tobacco) is less than \$60. Goods valued at less than NZ\$400 (A\$308), and on which no duty is payable, are exempt from GST. The threshold is lower where both duty and GST are payable.

The New Zealand Government recently reviewed the threshold applying to imported goods (NZ Customs 2011a). In an Issues Paper calling for public submissions, NZCS examined the operation of the de minimis (threshold) and the potential costs and benefits of any change. It concluded that 'the de minimis appears to be set at about the right level, based on the costs of revenue collection and

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compliance in the airfreight sector' (p. 14). A subsequent report to the Minister recommended that:

... the de minimis not be changed at this time. A higher de minimis would benefit importers and the fast freight sector, but the Crown would have to carry all of the consequential risk to its revenue base. If the current cargo reporting system for low value express airfreight had to be adapted to support a higher de minimis there would be a negative impact on risk management over non revenue items (eg illicit drugs and their precursors). A lower de minimis would not produce worthwhile net gains in Crown revenue and would increase compliance costs for importers. (NZ Customs 2011b, p. 1)

In March 2011, the New Zealand Customs Minister announced that the de minimis level, based on the taxes which would otherwise be collected, will remain at NZ\$60 (A\$46). The de minimis will next be reviewed as part of the implementation of the Joint Border Management System (Williamson 2011). In the longer term Customs will work with Inland Revenue to explore other methods of collecting GST revenue on imported goods (NZ Customs 2011b).

Currently, New Zealand Post is responsible for the initial identification of mail items which may be of interest. For private importations identified as exceeding the de minimis, a Customs officer creates a Personal Import Declaration in the Customs' goods processing system and Customs contacts the importer to arrange payment of the duty and a NZ\$22 processing fee. For commercial postal consignments, New Zealand Post or the importer's broker clear the parcels as commercial importations which attract a NZ\$25.30 import entry transaction fee and a NZ\$12.77 biosecurity levy. For air cargo parcels the importer, customs broker or express carrier is responsible for calculating the duty and taxes which are paid to NZCS along with an inward cargo transaction charge of NZ\$30.66.

### *United States*

In the US Congress there have been several recent proposals to increase the de minimis. In 2009, the proposed *Customs Facilitation and Trade Enforcement Reauthorization Act of 2009* was introduced in the Senate. The proposal would have increased to US\$500 (\$A447) the retail value of articles that may be imported duty-free into the United States. In 2010, the proposed *Customs De Minimis Adjustment Act of 2010* was introduced in the House of Representatives. It proposed increasing the de minimis to US\$1000 (\$A934). Neither of these acts passed before the end of the 111<sup>th</sup> Congress.

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In 2011, a new bill was introduced in the House of Representatives proposing to amend the US Tariff Act to increase the de minimis to US\$1000 (\$A934). The bill is being cosponsored by over fifty Democrats and Republicans.

A recent examination by Hufbauer and Wong, from the Peterson Institute for International Economics, of the broad effect of changing the de minimis in the United States, concluded that the benefits of a high threshold outweigh the costs. A paper recently submitted by the United States Government to APEC stated that raising the de minimis threshold for shipments entering the United States from US\$200 (\$A187) to US\$800 (\$A747) would produce net benefits to the United States.

While a higher de minimis exemption might reduce government revenue, it will also cut overall compliance costs, reduce delivery times, and encourage low value imports, especially direct purchases by consumers and small business firms from foreign suppliers. We estimate that the annual net gain from raising the de minimis threshold on the existing volume of US shipments would be about \$26 million, taking into account the cost savings to all affected parties – customers, express firms and U.S. Customs and Border Protection (CBP). In other words, the loss of tariff revenue and fees would be more than offset by the savings to the multiple parties in the delivery chain. (Hufbauer and Wong 2011, p. 1)

The US Customs and Border Protection Services is understood to be undertaking a cost accounting study that will assess the savings that could result from raising the de minimis threshold. However, details of the study are not yet available (Hufbauer and Wong 2011).

The procedure for collecting duty on incoming international mail are similar to those in other countries with low thresholds. Parcels are forwarded to one of US Customs and Border Protection (CBP) International Mail Branches for clearance. If the item is valued at above the US\$200 threshold, but less than US\$2000, a CBP official will prepare the paperwork for importing it, assess the proper duty, and release it for delivery. If any duty is owed a US\$5 processing fee (described as a nominal fee) is also charged. The duty and CBP processing fee are paid to the post office upon delivery. The US Postal Service also charges a Postal Service fee of US\$5.35 as partial reimbursement for its extra work in clearing parcels through CBP and delivering them. Parcels shipped by courier are expedited through CBP by a customs broker engaged by the carrier.

### *US Sales Tax*

It is also of interest that in the United States the non payment of state sales tax on some products sold interstate by online retailers has led to a somewhat similar

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debate around tax leakage and the impact of tax arrangements on competition between conventional and online retailers.

The United States does not have a national VAT/GST or sales tax regime. Instead 44 of the states, and the District of Columbia, each impose their own sales tax. The tax rates vary from state to state, but generally the state governments impose a sales tax of 4-7 per cent. The sales tax is second only to personal income taxes as the largest source of state revenue. Further, within each state, local government bodies also charge sales taxes which are added on to the state rate. For example, the state of Ohio has a state sales tax rate of 5.5 per cent, but after the county taxes are added there are six different rates of sales tax within the state ranging from 6 per cent to 7.75 per cent (Ohio 2011).

The US Supreme Court has ruled that states cannot require sellers to collect and remit sales tax unless the seller has a physical presence in the destination state. This has allowed online retailers in the United States to avoid having to pay state sales taxes on their interstate sales:

Local brick-and-mortar stores operate at a competitive disadvantage with remote sellers who don't collect or pay taxes. Local stores find themselves serving as showrooms for Internet and catalogue sellers. Prospective customers check out the merchandise locally but buy the product online or through a catalogue to avoid paying sales tax. Local merchants are at a competitive price disadvantage simply because remote sellers do not collect sales tax. (Streamlined Sales Tax Governing Board 2011, p. 1)

State governments in the United States have attempted to address this issue through several approaches. Some jurisdictions are applying a 'use' tax on the use in their state of goods which have been purchased in another state by requiring consumers to declare the amount on their annual income tax return. A Streamlined Sales and Use Tax Agreement has been implemented in twenty four states to streamline collection and enforcement procedures. Some states have taken legal action against online retailers. Texas, for example, has been pursuing Amazon for US\$269 million in uncollected sales tax (WSJ 2010). Some states have also amended their legislation to improve their ability to bring online retailers within their tax base. At the national level, a Main Street Fairness Act has been proposed to overcome the legal impediments created by the earlier Supreme Court ruling.

More recently, Amazon indicated that it would push for a voter initiative in California to eliminate sales tax for virtual sellers with only a modest physical presence in the state (Richtel and Kopytoff 2011). Subsequently, an agreement was reached under which Amazon will start collecting sales tax in California in September 2012 (Streitfeld 2011).

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# G Retail productivity

## G.1 What is productivity?

Productivity is a measure of how efficiently an individual business, industry or economy uses its resources to produce output. It can be measured as the ratio of outputs produced to the inputs used.

Single factor productivity accounts for one type of input only. Capital productivity measures output as a ratio to capital input whereas labour productivity measures output as a ratio to labour input. Single factor productivity growth serves only as a partial measure of how an economic entity has become more (or less) efficient because it does not take into account any changes in the use of other inputs. An increase in labour productivity based on hours worked, for instance, may not necessarily be due to more efficient use of labour, but may be due to increased use of other inputs such as capital, intermediate goods or human capital.

Multifactor productivity (MFP), on the other hand, is based on more than one type of input. It is measured as the unexplained or residual output growth, after increases in multiple inputs have been taken into account. MFP is often associated with technical improvement, which refers not only to technological advancement in the narrow sense, but includes more broadly, efficiency improvements from applied expertise or from ‘working smarter’ (for example, improving firm management strategies). Since it is a residual term, MFP will also capture all other factors which impinge on output growth such as efficiency gains from economies of scale.

## G.2 Measuring output in retail

Retail is part of the distribution sector and the output it produces is not the goods which it obtains from wholesalers or producers and then on-sells to the final consumer; rather, it is the bundle of services in sourcing, displaying and selling those goods. As is the case with other service industries, improvements (or otherwise) in the *quality* of retail service (such as convenience to consumers) are often difficult to capture in output measures.

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It is difficult to isolate the value of the retail services from the final price which a consumer pays for a good (Triplett and Bosworth 2004). Measures of retail output based on the retail margin (total sales less cost price of goods) assume that the margin is proportional to the value of the retail service to consumers. However, retail margins are influenced, not only by volume or quality of sales service, but also by such factors as the level of market competition and extent of economies of scale. Indeed, retail is a dynamic industry and its changes and innovations may not be captured by what is often a fairly stable real retail margin (Ratchford 2004). Nevertheless, retail margin serves as a starting point for measuring retail output.

In this report, the Commission uses a gross value added (GVA) measure of retail output. Generally, GVA refers the value of output produced in basic price terms (that is, less taxes plus subsidies), less the cost of intermediate inputs (which include materials, energy and business services used in the process of production, other than capital and labour). For the retail industry, this is equivalent to total sales, less the cost to the retailer of the goods sold, less intermediate inputs. A chain volume measure of GVA is used, which means that as far as possible, the effect of ‘pure’ price changes are removed so that all that is captured are quantum changes and, ideally, changes in quality.

### **G.3 Decomposing output growth**

Growth accounting addresses the question of what contributes to output growth. It involves attributing percentage point growth in retail output to different inputs (labour and capital); the residual output growth, or MFP, represents how efficiently they are combined or managed. The contributions of labour and capital are determined by multiplying the rate of growth for each input by its income share. Estimates of these contributions and of MFP are based on the neo-classical Cobb-Douglas production function (see box G.1) and assume that there are constant returns to scale, and that capital and labour are paid according to their marginal products.

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### Box G.1 Growth accounting in a Cobb-Douglas model

In the Cobb-Douglas production function, output produced at time  $t$  ( $Y_t$ ) is a function of inputs, capital ( $K_t$ ) and labour ( $L_t$ ), and  $A_t$ , which represents technical know-how:

$$Y_t = L_t^{(1-\alpha)} \times K_t^\alpha \times A_t$$

where  $\alpha$  is the capital share and  $(1 - \alpha)$  is the wage share.

Taking logs and the time derivative, *growth* of output can be represented as follows:

$$y = \alpha k + (1 - \alpha) l + a$$

where the use of the lower case denotes *growth* in income ( $y$ ), capital ( $k$ ) and labour ( $l$ ); growth in the variable  $A_t$ , denoted by  $a$ , is multifactor productivity growth.

That is, output growth is the sum of weighted growth in capital and labour inputs, and MFP growth. The break-down of retail output growth into these three components is shown below in figure G.1.

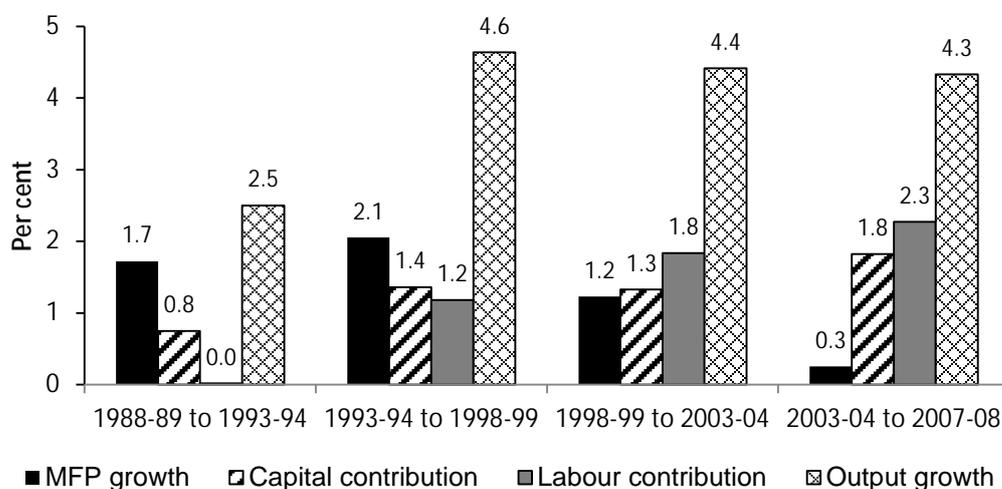
Labour productivity ( $LP$ ) growth is equal to the growth in output minus growth in labour inputs. So rearranging the equation above,

$$LP \text{ growth} = a + \alpha(k - l)$$

That is, labour productivity growth is the sum of  $a$  or MFP growth and capital deepening, represented by  $\alpha(k - l)$ . This breakdown is used as the basis for analysis of productivity trends in chapter 3.

The contribution of labour and capital inputs to retail output growth over the ABS market sector productivity cycles is shown in figure G.1. Even though there has been a significant *growth* in capital inputs in the retail industry since the mid-90s (as shown in chapter 3), its *contribution* to output growth has been relatively less than that of labour input. Retail remains a highly labour-intensive industry, with a labour income share of around 70 per cent.

**Figure G.1 Input contributions to retail output growth<sup>a,b</sup>**



<sup>a</sup> Includes motor vehicle and parts retailing and fuel retailing. <sup>b</sup> Output growth is the sum of the weighted growth of capital and labour inputs and MFP growth. Figures may not add due to rounding.

Data source: ABS (*Experimental Estimates of Industry Multifactor Productivity, Australia: Detailed Productivity Estimates*, Cat. no. 5260.0.55.002).

Growth in MFP was the most important contributor to retail output growth during the late 1980s and 90s. Johnston et al. (2000) attribute this to immediate trends occurring in the sector at the time which include rationalisation, the adoption of ICT and associated innovations and improvements in supply chains. These changes were driven by a higher degree of competition and higher demand growth sustained by rising incomes.

Since then, MFP growth has slowed and has become a less significant contributor to retail output growth. The main drivers behind the output growth in the most recent period, 2003-04 to 2007-08, were the growth in labour and capital inputs. Data for the most recent years, however, suggest that this decline in MFP growth may have been overstated (refer to chapter 3, footnote 5). Since 2007-08, there has been some labour shedding by the industry which has over-shadowed the decline in output growth and, based on the data currently available, MFP growth has subsequently improved (ABS 2010e).

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## H Impacts of reducing the LVT

The purpose of this appendix is to quantify the welfare impacts of reducing the low value threshold (LVT) on imports. The low value threshold determines the value at which imported goods are subjected to the GST and tariffs, and is currently set at \$1000.

The framework is designed to model the demand and supply for imported goods and their domestic substitutes; it also includes the revenue implications for government. The framework is used to calculate the likely welfare consequences of reducing the LVT, based on a range of different assumptions. Only the part of imports destined for consumers is modelled, since the part destined for businesses is exempted from GST and tariffs.

There are ‘neutrality benefits’ from imposing the GST on all goods (these benefits accrue mainly to producers and government), and there are costs associated with increasing the tax (and these costs are borne by consumers). The net effect cannot be determined theoretically and depends on the value of several parameters.

The analysis does not imply that the LVT should be lowered only if it is associated with a positive welfare impact; this standard is not used when deciding to impose a tax, since the imposition of a tax is typically welfare reducing. Tax collection is justified on the basis that the value of what is done with the revenue exceeds the costs of raising it.

Nonetheless, the calculations below show the welfare impacts to illustrate the orders of magnitude involved. As with any model, this one is a simple representation of the mechanisms at work and is only used for illustrative purposes.

### **Some illustrative calculations**

Taxing a previously untaxed good may or may not improve welfare. While broadening the tax base and removing the relative price distortion work to improve welfare, increased collection costs reduce welfare. The question of whether, on balance, the change in net welfare is positive depends on: the magnitude of the collection costs; the degree of substitutability between taxed and untaxed goods and

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the supply elasticity for the taxed good (box H.1). The efficiency cost of public funds is also relevant (box H.2).

Given data limitations the calculations in this appendix can only be suggestive of possible orders of magnitude but they do highlight the importance of the parameters mentioned above. As outlined in box H.3, the calculations are based on consumers substituting between LVT goods and domestic substitutes which are subject to the GST and tariffs. It is assumed that consumers choose a consumption bundle to maximise utility subject to an overall expenditure constraint. The utility function is calibrated to fit the observed expenditure and prices, and used to calculate the consumer response to price changes.

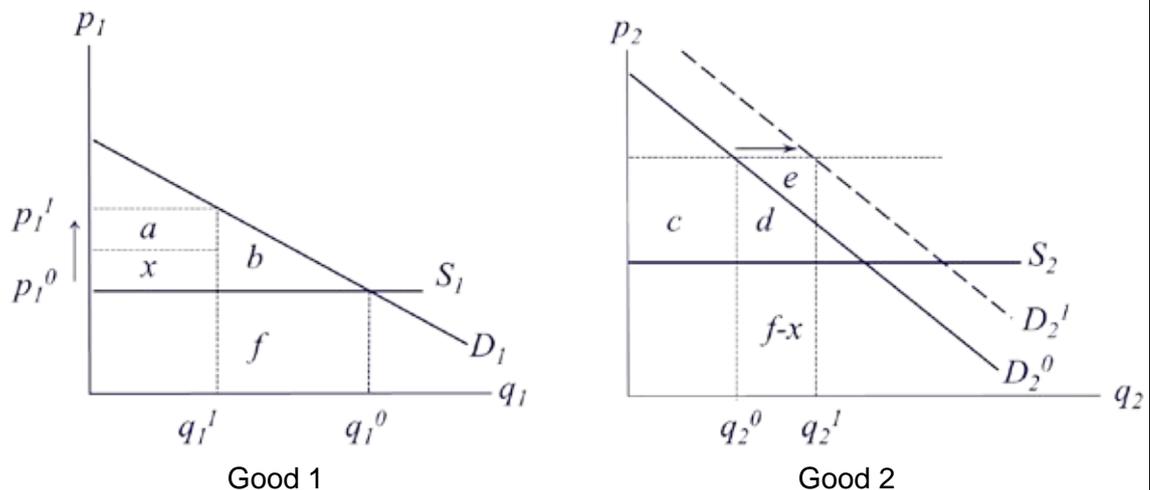
The model used measures welfare effects directly, by calculating the compensating variation associated with each simulation. The impact on consumers is measured as the income required for consumers to obtain the same level of utility as they do when the GST is not applied to LVT imports. Reflecting this, the welfare calculations reported in this appendix do not rely on the areas under the demand curves which are depicted in box H.1 to illustrate the intuition behind the results.

### Box H.1 Calculating the welfare effects of a tax increase

As explained by Jones (2005, p. 35) the deadweight loss of imposing a tax on an untaxed good can be greater or less than zero when there are existing taxes on other goods. When the tax is imposed, it increases the demand for substitutable goods that are already taxed. This welfare gain is captured by the additional tax revenue obtained from those markets.

The net result is that welfare increases if the deadweight loss in the newly-taxed market is less than the extra tax revenue generated in previously taxed markets. An additional adjustment needs to be made when resources are used in collecting taxes (Slemrod and Yitzaki, 1996). These costs on the newly taxed good are additional to the regular deadweight losses and must be offset against any extra tax revenue.

The following diagrams illustrate a simple case with two goods, constant producer prices and a fixed consumer budget constraint.



Initially good 1 (left-hand diagram) is untaxed and good 2 (right-hand diagram) is taxed so that it raises  $c$  dollars in revenue. If good 1 is then taxed, its price rises from  $p_1^0$  to  $p_1^1$ . This price increase includes additional taxes ( $a$ ) and collection costs that are assumed to be borne by consumers ( $x$ ). The result is a decrease in the quantity of good 1 consumed (from  $q_1^0$  to  $q_1^1$ ) and a shift in demand for good 2 from  $D_2^0$  to  $D_2^1$ .

Consumers' surplus decreases by  $a+x+b$  dollars while tax revenue increases by  $a+d+e$  dollars. Area  $f$  represents the savings in expenditure on good 1 which, after subtracting the tax expense of  $a$  dollars and the resource costs of  $x$  dollars involved in complying with the tax on good 1, is expended on good 2.

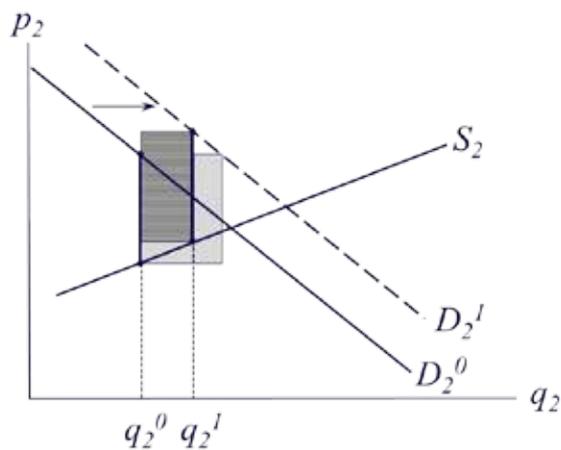
The tax on good 1 improves welfare if the total increase in tax revenue ( $a+d+e$ ) is greater than the loss in consumers' surplus ( $a+b+x$ ), or equivalently, if the increase in tax revenue on good 2 ( $d+e$ ) is greater than the deadweight loss ( $b+x$ ) which includes both the regular deadweight loss ( $b$ ) and the loss due to compliance costs ( $x$ ). This analysis follows the approaches in Mishan (1973), Jones (2005) and Mishan and Quah (2007).

(continued next page)

**Box H.1 continued**

Further complications arise if the supply price of good 2 is not constant but rises instead. Although the magnitude of the net benefits differs, the above basic principles still hold; imposing a tax on good 1 expands consumption and production of good 2, increasing government revenues from good 2. As before, there is a beneficial expansion in consumption and production of good 2 because the marginal valuation exceeds the marginal cost of production. And there is an increase in the tax revenue collected on good 2, and an increase in producers' surplus in market 2. However compared to the constant price case, the net benefits of imposing a tax on good 1 is moderated.

This can be seen in the following diagram of the supply and demand for good 2 where the demand curves for good 2 and tax rates are the same as previously, but supply is upward sloping. In this diagram the lightly shaded rectangle is the amount of additional tax revenue collected from good 2 when the marginal cost was fixed, equal to areas  $d+e$  in the previous diagram.



Good 2

In this case as a tax is imposed on good 1 and demand for good 2 increases, there is an increase in both the producer and consumer prices of good 2. The higher producer price encourages additional resources to be drawn into the production of good 2 and increases producers' surplus in the production of good 2. The higher consumer price discourages consumption of good 2 compared to the constant price case so that  $q_2^1$  is less than it was in the previous diagram. With a smaller increase in consumption of good 2, the additional tax revenue collected on good 2 – shown by the dark shaded rectangle – is also smaller. In sum, the net welfare benefits of imposing a tax on good 1 are smaller when there is a lower supply elasticity for good 2, all else the same.

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## **Box H.2    Efficiency cost of public funds**

The marginal efficiency cost of public funds measures the cost to society of raising a dollar through particular taxes. This cost generally exceeds the nominal value of the tax collected because of the deadweight losses associated with the distortion of relative prices and the compliance and administration costs of taxes.

That said, in the case of lump-sum taxes with no collection costs, the cost of raising a dollar in tax revenue is equal to a dollar. When correcting a distortion, the cost of raising a dollar of tax revenue (with no collection costs) is less than a dollar. Tax collection is best achieved by relying less on taxes with high efficiency cost and more on taxes with a low efficiency cost.

*Source:* (Slemrod and Yitzhaki, 1996)

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### Box H.3 **Measuring the welfare effects of price changes**

The welfare calculations used in this appendix are based on a simple model of consumer demand. Consumers are assumed to maximise utility by consuming a range of goods (which consist of imported LVT goods, domestic substitutes for LVT goods, and other consumption) subject to a fixed budget constraint. The impact of the price changes on consumers is measured by compensating variation — the level of additional income that consumers would require to reach their initial level of utility.

The calculations in this appendix assume that the direct utility function for a representative consumer is a Constant Elasticity of Substitution (CES) function, nested within a Cobb-Douglas function (Keller, 1976; Rutherford, 2002). The substitution elasticity between LVT imports and domestic substitutes is constant. Consumers also choose between the (imported and domestically produced) composite LVT goods and the remainder of household consumption. The Cobb-Douglas form implies that consumers allocate fixed budget shares to each component.

This utility function is calibrated to estimated expenditure on the three types of goods: LVT imports equal \$4.2b (based on CAPEC – sub 90); domestic LVT substitutes equal \$115b (retail sales excluding food retailing and cafes for 2010-11 from ABS Retail Trade, Catalogue 8501.0); and a residual consumption of \$758b. Prices for the three goods are respectively 1.0, 1.125 (including GST and tariffs) and 1.1 (including GST).

The total collection costs associated with lowering the LVT are assumed to be split between consumers and government in approximate 70–30 proportions.

In tables H.5 and H.6, which report the effects of reducing the LVT to \$100 and \$500 respectively, it is assumed that there are three goods in the lower level utility function — LVT imports, imports currently identified as LVT but subject to tax in the simulation, and domestic substitutes. In table H.5, calibrated expenditure on goods below \$100 is \$1.7b and expenditure on goods above that threshold is \$2.5b. In table H.6, calibrated expenditure on goods below and above \$500 is \$3.3b and \$0.9b.

The General Algebraic Modeling System (GAMS) software has been used for all calculations.

Table H.1 provides illustrative calculations of the effects of lowering the LVT to \$0 with average collection costs equal to \$50 per item for a range of elasticities of substitution between LVT goods and domestic substitutes. The total values of impacts on consumers, producers and government net tax revenue are shown. Also shown is the breakdown into components of the total impacts on consumers and on net government revenue. The calculations are based on a perfectly elastic supply of domestic substitute goods and thus there is no change in producer impacts.

**Table H.1 Illustrative welfare effects of reducing the LVT to \$0 with \$50 collection costs**

Perfectly elastic supply of domestic substitutes  
(\$ million)

<i>Substitution<sup>a</sup></i>	<i>'Low'</i> <i>s = 1</i>	<i>'Medium'</i> <i>s = 2.5</i>	<i>'High'</i> <i>s = 5</i>
<b>Consumer welfare</b>	<b>-2532</b>	<b>-1682</b>	<b>-968</b>
Collection costs	-1631	-666	-146
Other	-901	-1016	-822
<b>Producer welfare</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Net tax revenue</b>	<b>-476</b>	<b>81</b>	<b>381</b>
Collection costs	-760	-311	-68
Tax revenue	284	391	449
<b>Net welfare</b>	<b>-3008</b>	<b>-1601</b>	<b>-587</b>
<i>Changes in:</i>			
Price of LVT goods	84%	84%	84%
Imports of LVT goods	-46%	-78%	-95%

<sup>a</sup> In the CES function, a *s* parameter value of 1 implies an elasticity of substitution of zero and zero cross-price substitution. Cross-price substitution increases as parameter *s* is increased (Rutherford 2008).

<sup>b</sup> Consumer impact is measured by compensating variation. Consumers maximise utility subject to a fixed budget constraint. From this optimisation process, the indirect utility function is calculated, and the expenditure function is solved for the initial level of utility and final prices.

Table H.1 highlights the importance of collection costs on LVT goods. At \$50 per item, total collection costs are very large relative to other components of welfare. For all levels of substitution from none to 'high', collection costs are so large that the change in net welfare from reducing the LVT is negative.

It is also clear in table H.1 that substitutability is important in determining the magnitude of the changes. As substitutability increases, there is a greater consumption response to the 84% increase in the price of LVT goods with less LVT goods being consumed and a greater shift in demand towards domestic substitutes. Larger substitutability results in a smaller loss in consumer impacts, smaller total collection costs on LVT goods, greater tax revenue and, therefore, larger net benefits.

Table H.2 provides further illustrative calculations of the welfare effects of lowering the LVT to \$0 for a range of collection costs (from \$50 down to \$0) and using the same elasticity parameter values as in table H.1. For comparison, the first block of rows in table H.2 (for collection costs equal to \$50) repeats the welfare effects given in table H.1.

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Table H.2 shows that, as collection costs are reduced, the welfare benefits of reducing the LVT to \$0 can become positive. And with collection costs equal to \$0, eliminating the LVT could be welfare improving for medium to high substitution parameters (\$13 and \$70 million, respectively). These amounts give a rough indication of the value of removing the distortion. The bottom row in table H.2 presents the calculation of what the collection cost per item would have to be for the policy to have zero net welfare impact; for example, with a high substitution parameter, if the collection cost per item is below \$1.40, then eliminating the LVT is welfare improving, whereas per item collection costs above \$1.40 are welfare decreasing.

The importance of collection costs relative to the value of the LVT goods is illustrated further in table H.3. Since the per item collection costs are assumed to be independent of the value of the parcel, the modelled effects on the average prices of LVT goods increases as the LVT is lowered.

Table H.4 illustrates the importance of the supply elasticity in calculating the welfare implications of lowering the LVT to \$0, assuming collection costs are \$50. Again, for comparison, the first block or rows repeats in summary form the results from table H.1 based on a perfectly elastic supply and no change in producer impacts. As would be expected, if supply is less elastic and if goods are more substitutable in demand, the change in producer impacts are greater. The total effect on net welfare is less beneficial when supply is less elastic.

**Table H.2 Illustrative welfare effects of reducing the LVT to \$0 with different collection costs**

Perfectly elastic supply of domestic substitutes  
(\$ million)

<i>Substitution</i>	<i>'Low'</i> <i>s = 1</i>	<i>'Medium'</i> <i>s = 2.5</i>	<i>'High'</i> <i>s = 5</i>
<i>[1] Collection costs \$50</i>			
Consumer welfare	-2532	-1682	-968
Producer welfare	0	0	0
Net tax revenue	-476	81	381
<b>Net welfare</b>	<b>-3008</b>	<b>-1601</b>	<b>-587</b>
<i>[2] Collection costs \$25</i>			
Consumer welfare	-1641	-1250	-840
Producer welfare	0	0	0
Net tax revenue	-119	137	341
<b>Net welfare</b>	<b>-1760</b>	<b>-1114</b>	<b>-499</b>
<i>[3] Collection costs \$12.50</i>			
Consumer welfare	-1108	-920	-691
Producer welfare	0	0	0
Net tax revenue	133	240	348
<b>Net welfare</b>	<b>-974</b>	<b>-680</b>	<b>-343</b>
<i>[4] Collection costs \$0</i>			
Consumer welfare	-492	-453	-395
Producer welfare	0	0	0
Net tax revenue	466	466	466
<b>Net welfare</b>	<b>-27</b>	<b>13</b>	<b>70</b>
<i>Break-even collection costs (\$)</i>		0.18	1.40

**Table H.3 Average increases in prices from lowering the LVT<sup>a</sup>**

Three levels of LVT

<i>Reducing LVT to:</i>	<i>Per cent change</i>
\$500	+24
\$100	+36
\$0	+84

<sup>a</sup> Assuming collection costs = \$50 per item.

**Table H.4 Illustrative welfare effects of reducing the LVT to \$0 with different supply elasticities**

Collection costs \$50

(\$ million)

<i>Substitution</i>	<i>'Low'</i> <i>s = 1</i>	<i>'Medium'</i> <i>s = 2.5</i>	<i>'High'</i> <i>s = 5</i>
<i>[1] Perfectly elastic supply</i>			
Consumer welfare	-2532	-1682	-968
Producer welfare	0	0	0
Net tax revenue	-476	81	381
<b>Net welfare</b>	<b>-3008</b>	<b>-1601</b>	<b>-587</b>
<i>[2] Supply elasticity = 10</i>			
Consumer welfare	-2348	-1743	-1250
Producer welfare	-13	179	308
Net tax revenue	-529	-75	234
<b>Net welfare</b>	<b>-2890</b>	<b>-1639</b>	<b>-708</b>
<i>[3] Supply elasticity = 5</i>			
Consumer welfare	-2175	-1725	-1391
Producer welfare	-39	258	459
Net tax revenue	-565	-200	57
<b>Net welfare</b>	<b>-2780</b>	<b>-1667</b>	<b>-874</b>

Tables H.5 and H.6 present the calculated effects of lowering the LVT to \$100 and \$500, respectively, for different collection costs and demand substitution elasticities.

A comparison of tables H.2, H.5 and H.6 reveals that at various levels of unit collection costs there is less welfare loss when the LVT is reduced by less. For example, with collection costs of \$50 and high substitution, reductions in the LVT to \$0, \$100 and \$500 are calculated to result in net welfare changes of -\$0.6, -\$0.2 and -\$0.05 billion, respectively.

The model can be used to produce 'break-even' collection costs – that is, the collection costs that would produce a net welfare effect zero. This shows that, the lower the LVT, the lower the collection costs need to be to produce a zero net welfare impact. Assuming high substitutability, the break-even costs are \$5.88 to lower the LVT to \$100 and \$9.68 to lower the LVT to \$500.

**Table H.5 Illustrative welfare effects of reducing the LVT to \$100 with different collection costs**

Perfectly elastic supply of domestic substitutes  
(\$ million)

<i>Substitution</i>	<i>'Low'</i> <i>s = 1</i>	<i>'Medium'</i> <i>s = 2.5</i>	<i>'High'</i> <i>s = 5</i>
<i>[1] Collection costs \$50</i>			
Consumer welfare	-640	-533	-403
Producer welfare	0	0	0
Net tax revenue	95	151	209
<b>Net welfare</b>	<b>-545</b>	<b>-382</b>	<b>-194</b>
<i>[2] Collection costs \$25</i>			
Consumer welfare	-473	-413	-334
Producer welfare	0	0	0
Net tax revenue	180	203	229
<b>Net welfare</b>	<b>-293</b>	<b>-210</b>	<b>-104</b>
<i>[3] Collection costs \$12.50</i>			
Consumer welfare	-385	-345	-289
Producer welfare	0	0	0
Net tax revenue	227	237	248
<b>Net welfare</b>	<b>-158</b>	<b>-108</b>	<b>-41</b>
<i>[4] Collection costs \$0</i>			
Consumer welfare	-294	-270	-236
Producer welfare	0	0	0
Net tax revenue	278	277	276
<b>Net welfare</b>	<b>-16</b>	<b>7</b>	<b>41</b>
<i>Break-even collection costs (\$)</i>		0.73	5.88

**Table H.6 Illustrative welfare effects of reducing the LVT to \$500 with different collection costs**

Perfectly elastic supply of domestic substitutes

(\$ million)

<i>Substitution</i>	<i>'Low'</i> <i>s = 1</i>	<i>'Medium'</i> <i>s = 2.5</i>	<i>'High'</i> <i>s = 5</i>
<i>[1] Collection costs \$50</i>			
Consumer welfare	-184	-158	-126
Producer welfare	0	0	0
Net tax revenue	60	70	81
<b>Net welfare</b>	<b>-123</b>	<b>-88</b>	<b>-45</b>
<i>[2] Collection costs \$25</i>			
Consumer welfare	-146	-130	-108
Producer welfare	0	0	0
Net tax revenue	79	83	88
<b>Net welfare</b>	<b>-66</b>	<b>-46</b>	<b>-20</b>
<i>[3] Collection costs \$12.50</i>			
Consumer welfare	-126	-114	-97
Producer welfare	0	0	0
Net tax revenue	90	91	93
<b>Net welfare</b>	<b>-37</b>	<b>-23</b>	<b>-4</b>
<i>[4] Collection costs \$0</i>			
Consumer welfare	-106	-97	-85
Producer welfare	0	0	0
Net tax revenue	100	100	99
<b>Net welfare</b>	<b>-6</b>	<b>2</b>	<b>14</b>
<i>Break-even collection costs (\$)</i>		1.14	9.68

## Conclusion

The modelling in this appendix illustrates the orders of magnitude involved in reducing the LVT under various assumptions about key parameters. In particular, the modelling highlights that total collections costs are very large, especially when compared with the potential gains from lowering the LVT. Significant reductions in per item collection costs could reduce the costs of reducing the LVT. The net welfare effects of lowering the LVT are usually negative, in large part due to the collection costs. That said, any decision to lower the LVT would also have to take into account the value of raising taxes from this source, either in terms of reductions in more costly tax collection or in terms of the benefits that can be derived from additional government expenditure.

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