

**Submission to the Productivity Commission**

Inquiry into the

**Economic Structure and Performance of the Australian Retail Industry**

February 2011

## **1.0 Introduction**

The National Baking Industry Association (NBIA) is the marketing arm of the Baking Industry Group. The Baking Industry Group is a not for profit organisation, whose role is to provide industry leadership to develop, support and protect the principles of efficiency, quality and best practices in the Baking Industry. With membership in every State of Australia, the Baking Industry Group prides itself on being the national body for the baking industry, playing a vital role in the development, promotion, education, training and protection for business owners within this industry. With close to 400 members, membership ranges from small corner store bakeries to large milling companies. While our membership is diverse, all members are committed to safeguarding the industry and providing the best quality outcomes to consumers.

## **2.0 The Inquiry**

The Productivity Commission is undertaking an inquiry into the economic structure and performance of the retail industry. In particular the Commission will be examining:

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.

Whilst we do represent wholesale companies, we also represent retailers, who are predominately small businesses. As a large part of the baking industry is within the retail sector, we are committed to ensuring the sustainability and profitability of the retail industry.

## **3.0 The current structure, performance and efficiency of the retail sector and impediments to its contribution to the Australian economy**

The Australian Baking Industry is dynamic and has been in constant change for a number of decades. The sector can be categorized into four groups, by business model:-

- corporate plant bakeries;
- traditional hot bread shops;
- franchised hot bread shops; and
- supermarket in-store bakeries.

Corporate plant Bakeries produce bread for wholesale distribution and exporting, and account for the majority of bread production. Traditional hot bread shops have on-site manufacturing and retailing and are the second largest producers of bread products. Franchised hot bread shops represent a growing area of the bread sector with on-site manufacturing and retailing. Supermarkets have diversified into in-store bakeries to encourage purchasing across the supermarket and compete with franchised hot bread shops. The impact of the economic slowdown saw a trend resulting in consumer groups going for home-prepared lunches which

increased the sale of packaged/industrial bread. Private label continued to grow within baked goods, accounting for an overall value share of more than 8% during 2009. Supermarket retailers tend to aggressively push their private label products via price discounting and multi-pack promotions, particularly for packaged/industrial bread within which private label reached 22% of total value sales that year. They are also tending to stock fewer branded products within packaged/industrial pastries and cakes, where private label value shares rose to 52% and 35% respectively (Source: Euromonitor International October 2010).

Previously, competition between the on-site operations is strong which has forced the prices of their products down, often to the point where the products are cheaper than the packaged equivalent produced by corporate plant bread bakeries. Consequently the on-site operations are gaining market share while the plant bread market share is in steady decline, which has caused the corporate plant bakeries to diversify. However, now with the supermarket's reduction in the price of bread, it is our perception that this trend has been reversed and forced a significant downturn in trade for retail bakeries.

Apart from bread loaves, the bread sector produces a range of products. These products include English muffins, rolls and buns, specialty bread, flat bread, buttered bread, crumpets and breadcrumbs.

### **Sector performance**

Baked goods grew by 5% in current value terms with sales reaching A\$5,383 million in 2010.

#### ***Sale of Baked Goods by Category: Volume and Value 2008-2010***

'000 tonnes & A\$ million

<b>Product</b>	<b>2008 Volume</b>	<b>2008 Value</b>	<b>2009 Volume</b>	<b>2009 Value</b>	<b>2010 Volume</b>	<b>2010 Value</b>
<b>Bread</b>	<b>602.8</b>	<b>\$3,057.3</b>	<b>622.3</b>	<b>\$3,195.8</b>	<b>639.4</b>	<b>\$3,355.8</b>
Bread Substitutes	2.1	\$34.9	2.2	\$37.4	2.2	\$39.4
Packaged /Industrial Bread	311.0	\$1,504.3	320.3	\$1,572.0	328.3	\$1,650.6
Unpackaged/Artisanal Bread	289.7	\$1,518.1	299.9	\$1,586.4	308.9	\$1,665.7
<b>Cakes</b>	<b>72.5</b>	<b>\$839.7</b>	<b>74.8</b>	<b>\$872.1</b>	<b>76.8</b>	<b>\$912.5</b>
Packaged/Industrial Cakes	13.7	\$125.0	14.0	\$128.7	14.2	\$131.9
Unpackaged/Artisanal Cakes	58.7	\$714.8	60.8	\$743.3	62.6	\$780.5
<b>Pastries</b>	<b>105.0</b>	<b>\$1,045.1</b>	<b>108.4</b>	<b>\$1,084.3</b>	<b>110.5</b>	<b>\$1,115.0</b>
Packaged/Industrial Pastries	15.9	\$105.3	16.2	\$106.9	16.4	\$108.3
Unpackaged/Artisanal Pastries	89.1	\$939.8	92.2	\$977.4	94.0	\$1,006.7
<b>Baked Goods</b>	<b>780.3</b>	<b>\$4,942.2</b>	<b>805.5</b>	<b>\$5,152.2</b>	<b>826.7</b>	<b>\$5,383.3</b>

*Euromonitor International*

#### ***Impediments to the Baking Industries Contribution to the Australian Economy***

The Infrastructure costs such as the high rental in shopping centres is an impediment to the Baking Industries contribution to the Australian Economy.

Legislation and rental tenancy agreements that dictate opening and closing times impact on the Baking Industry. The large Shopping Centres' operating hours especially for public holidays combined with penalty rates and the consumer legislation pertaining to the administrative workload to increase prices is creating problems for small bakeries. Independent retail bakeries also face the obstacle of rising operational costs such as increases to the minimum wage and a lack of suitable sites resulting from the slow-down in shopping centre development.

Human Capital and the lack of skilled Bakers within Australia is also impacting on the industries ability to diversify and gain market share over imported products. The labour cost, in particular the cost of penalty rates for public holidays and out of ordinary hours provisions, is an impediment.

Commodity prices impact on the Baking Industry nonetheless, unit prices for baked goods are expected to remain more or less stable since price discounting and promotional activities are being aggressively undertaken by both branded manufacturers and private label retailers.

The price war by the major supermarkets will have a detrimental effect on the independent retail bakeries who up until 2009 had maintained their dominance in the market by holding 64% of market share. However, the impact of the price war on bread by the supermarket chains has seen many of the independent retail bakeries sale figures drop significantly. Independent retail bakeries operate on a minimum profit margin, therefore a drop of the sales of this magnitude will see many of these independent retail bakeries go out of business. This will have a detrimental effect on the Australian economy as these independent retail bakeries predominately employ 1 to 19 employees according to ABS data.

### ***International trade***

As the bread sector is focused on supplying the domestic market, sales from exports account for less than one per cent of turnover in bread manufacturing. In 2001-02 exports of bread products were valued at \$4.9 million. The perishable nature of the product and economies of scale with logistics are the main obstacles for exporting, however frozen doughs and par-baked products are emerging as export opportunities particularly to Asian markets. IBIS World (2003a) has estimated that the value of exports has been increasing in real terms by an average of 31 per cent annually since 1997-98, albeit from a very low base.

Bread is the dominant sector of the bakery market. Pan or loaf bread accounts for 45% of the domestic market in Australia; however, wheat exported for pan production only accounts for 10% of total exports. A substantial growth area on export markets in the bread and baking industry over the last 10–15 years has been wheat milled for flat bread production. In the Middle East, flat bread is the predominant form consumed. Up to 40 percent of Australia's wheat exports are processed for flat bread production with the major markets being Egypt, Iran, Iraq and the Gulf countries. Flours that produce the best flat breads are those milled from white wheats that are not excessively soft, and AH and ASW varieties satisfy these requirements well. Wheat that is milled for flat bread production should have protein content no less than 10% and dough properties that are extensible rather than stable characteristics. However the wheat is not value added in Australia to export the flat bread.

Across Asia, the bread sector is growing, reflecting the move to more westernised consumption patterns; there is a greater emphasis on convenience and increased consumption of fast foods. In Asia, the 'Sponge and Dough' method tends to be the most common method of making bread. This process produces a very soft Asian-style bread and the taste created through the fermentation process is preferred. In contrast this process is not commonly used in Australia where most bread is produced using the 'Rapid Dough' method. In the sponge and dough method a sponge is prepared containing most of the flour, water and yeast, allowed to ferment for 3 to 4 hours and then remixed with the rest of the ingredients and processed in the traditional manner. In Australia the sponge and dough bread making process is used to make bread rolls for the fast food industry. Sponge and dough bread in Asia is a key export market goal in the development of more targeted wheats to make specific end products. This \$1B Asian sponge and dough wheat market is being targeted by DPI&F and CSIRO Food Futures National Research Flagship in a collaborative project with support from the Grains Research and Development Corporation. This project is working with each of the Australian wheat breeding programs to identify wheat lines and varieties with superior sponge and dough bread quality. In 2008, the variety EGA Kidman was released in Queensland specifically for the sponge and

dough bread market. However again this is an export market opportunity which has not been taken up by the Baking Industry for them to enter into this Marketing field.

Whilst Australian Baking Industry has been slow to grow the export Market we have seen an increase in par-baked products particularly from the USA (California) into large supermarket chains sold at cheaper prices than that of home grown par-baked products.

### ***Recommendations***

1. The Productivity Commission recommends that the price fixing legislation be enhanced to ensure that the dominant markets can not concurrently discount the price of bread and baked products below relevant cost.
2. That the Productivity Commission addresses the price discounting and dumping on the Market by the large supermarket chains.
3. That the Productivity Commission looks at introducing export assistance to Bakeries to develop overseas markets.

#### **4.0 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**

As stated above the bread sector is focused on supplying the domestic market, as such, sales from exports account for less than one per cent of turnover in bread manufacturing. In 2001-02 exports of bread products were valued at \$4.9 million. The perishable nature of the product and economies of scale with logistics are the main obstacles for exporting, however frozen dough's and par-baked products are emerging as export opportunities particularly to Asian markets. IBIS World (2003a) has estimated that the value of exports has been increasing in real terms by an average of 31 per cent annually since 1997-98, albeit from a very low base.

The value of imported bread products is also negligible but growing, accounting for less than one per cent of domestic consumption, or \$0.2 million, in 2001-02. Data from IBIS World shows that the value of bread imports has remained steady since 1997-98.

### ***Employment***

- The bakery manufacturing sector is the second largest employer in Australia's processed foods industry.
- Employment has remained relatively static in total across the three sectors (excluding supermarket in-store bakeries)
- Structural shifts in the industry have impacted on the delivery of public training courses provided through TAFE institutes and most Bakeries cannot access off-the-job training and need increases in training delivered on-the-job because the machinery often used in the TAFE is different to the machinery used in the Bakery.
- Franchises and in-store bakeries are increasing their demand for customised courses.
- With the Australian Bread sector having been in a state of change due to Government policy and a growing public interest in food and nutrition, the industry has seen a rise of a small but growing Australian artisan baking sector. This gives rise to the problem of insufficient skilled artisan bakers, viewed with the fact that the baking industry is identified on the National skills shortage list, there is

considerable scope for improving skills and education across the sector. Magee's Fellowship identified five main areas of skill deficiencies in the baking industry:

1. The use of whole grains and specialty flours in artisan bakery, with particular emphasis on whole grain and specialty flour in high hydration doughs.
2. The use of sour-culture in sweet breads and flourless breads, including the manufacturing parameters of sugar content, culture percentage and the dough tolerance in mixing and proving.
3. the use of pre-ferments in advanced artisan bread, with focus on determining optimum pre-ferment percentage and the techniques for using high-ash flours, spouted grains and whole grain starters.
4. The use of retarding techniques in artisan baking.
5. The use of bread concentrates and dough conditioners in artisan baking.

(Source: Whole Grains and Specialty Flours in Artisan Bakery)

- Legislative drivers for training to manage food safety, labelling and OH&S are now stronger than the demand for skills based training.
- Technology developments in ingredients and premix formulations as well as automation have also fostered a decrease in the industry skills base.
- Industry perceives a general disconnect between the courses offered and requirements of the industry.

### ***Health and nutrition***

In the 1960s, the misconception that carbohydrates were fattening decreased bread consumption, particularly amongst those concerned about their body weight.

Since the 1980s, increasing scientific evidence supports a link between diet and disease. Wholegrain breads, which are higher in fibre, are becoming more mainstream as the link between bowel cancer and dietary fibre becomes accepted.

The balancing act between ensuring the quality of the bread in relation to form, texture, colour and consumer acceptance and that of health concerns is being taken seriously by the industry. The industry has looked at reduction of sodium levels and increase in fibre and maintaining low saturated fat and partially hydrogenated fat content, for example feedback from the industry is that with current technology, a salt content of lower than 400mg/100g is not feasible without a change in consumer acceptance with the exception of fruit bread where the sugar content enables a lower sodium content of around 380mg/100g of flat unleavened breads.

With access to more information on the relationship between diet and health, consumers are recognising the role of healthy eating in achieving optimal health. They are assuming greater personal responsibility for the health of their family by taking more care in choosing nutritious foods and are interested in receiving information about nutrition. However research suggests that they respond better to gradual reductions where the impact on taste is not so obvious. The bread industry has responded to consumer interest in nutrition by developing breads in the functional foods category. A food is defined as a functional food when it offers health benefits other than the provision of simple nutrients. Promoting the positive health benefits of resistant starch and soy, found in breads such as Wonder White and Burgen Soy Lin, is an important strategy for bread marketing.

### ***Technology Changes***

After WWII, there were significant technological changes, especially associated with automation.

Mechanisation led to the establishment of large fully automated and quality controlled plant bakeries. Small bakeries could not compete with the efficiency of these large plant bakeries and were absorbed by them.

Production time was further reduced with the introduction of the rapid dough process, a technique developed by the Bread Research Institute of Australia which reduces the time required for dough development by the addition of oxidising agents such as vitamin C (ascorbic acid).

Processing methods and packaging allowed bread to stay fresh for several days, increasing its shelf life.

We in the Baking Industry are concerned about the dilution of skills, however pre-mixed flours, automated equipment and frozen doughs allowed hot bread shop owners, who were initially not bakers, to specialise and compete with the larger manufacturers. It also made it possible to provide a continuous supply of fresh bread.

### *Energy Efficiency*

Work was undertaken in 2003 to establish a show case bakery in Mascot in Sydney as an innovative project to demonstrate energy efficiency best practice for bakeries. This was undertaken in partnership with Baker's Delight and industry suppliers under the (EEBP) program of the Commonwealth department of Industry, Tourism and Resources. The project achieved a 32% saving in annual energy costs and a reduction of 48% in green house gas emissions per year, compared to the standard Baker's Delight bakery. At the end of the project more than 16 areas of improvement in energy performance were identified, these included oven efficiency, refrigerator and hot water supply. They also identified other environmental practices requiring attention such as waste minimisation, water conservation and purchasing energy from renewable sources.

The show case was a working demonstration of how best practice and innovation can help test new concepts and technology to change the Baking Industry's normal practice. Suppliers agreed that the energy efficiency improvement trailed at the show case bakery would be of benefit to the entire Baking Industry and as stated by Ron Trelora, National Sales Manager for Moffat Australia, "We've taken the first steps, but have only scratched the surface in terms of possibilities, we know there is scope for even further improvements." (Source: Achieving results in the bread baking sector)

Whilst this project demonstrated that major efficiency gains are possible, more work is needed. The average independent retail bakery does not have the expertise nor the financial viability to develop the skills and resource the technology needed to improve their energy ratings.

### **Recommendations**

4. That the Productivity Commission recommends changes in the Training Packages for Bakers to address the five identified main areas of skill deficiency outlined above.
5. The Productivity Commission should recommend that the Government fund more research and development into improvements in energy efficiency for the Baking Industry.

### **5.0 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**

Whilst there is a shortage of data in regard to the number of goods sold on line and the impact that has had on the retail baking industry, we know antidotically that this is occurring.

The number of web sites to show the on line purchasing of baked goods and par baked goods has increased.

The selling of overseas goods has increased in the specialty line and this shows particularly in the area of those specialty goods that would be classed as attracting GST if purchased in Australia. For example the purchase of overseas cakes such as wedding cakes and Christmas cakes.

The fact that Baked products such as cakes, pastries, pies and sausage rolls can be purchased on line and do not attract GST does not create a level playing field for small bakeries in Australia.

### **Recommendations**

6. The Productivity Commission recommends a reduction to the current threshold on GST on imported goods of \$1000, to allow independent bakers to compete on a level playing field.

## **6.0 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**

The different ways in which bakeries are structured creates problems in relation to how they pay their taxes and creates impediments, for example:

Sole Traders – of which many Bakeries are. Their income is treated as the person's individual income. Therefore sole traders pay the same tax as individual taxpayers – that is at the 'marginal' tax rates.

A Partnership is not a separate legal entity and does not pay income tax on the income earned by the partnership, instead, the partners pay tax on their share of the new partnership income.

Pty Ltd Companies – Money earned by the business belongs to the Company. Company tax rates are lower than personal tax rates.

The amount of red tape and administrative nightmare that has been imposed on small retail businesses including bakeries by the various governments has necessitated the need for small businesses to purchase in skills to undertake the work required by government. This has resulted in high costs for small retailers thus reducing their profit margin.

The amount of increasing legislative compliance on small retailers is well outside the scope and knowledge of the individual owner's ability to remain informed and thus causes concern for them in regard to compliance.

As stated at point 5.0, Bakeries must pay GST on some of their products and not on others which means that they need to differentiate between products requiring GST to be paid. The small businesses need to register for GST when their annual turnover reaches \$75,000 or more. For those bakeries that are registered for GST they can claim input tax credits for GST and the reporting process will depend on whether they registered to report monthly or quarterly.

For those Bakeries that own their premises the State Governments impose annual tax on the total unimproved value of all land owned.

### ***For Bakeries with staff***

All Bakeries that employ staff have Pay As You Go instalments (PAYG), pay superannuation and pay fringe benefits.

They have to register for PAYG withholding, calculate how much to withhold from payments and report and pay the withheld amount.



Fringe Benefits is separate to income tax, which necessitates increased administration.

Pay-roll tax is the other State tax which varies between states and is calculated on wages paid by an employer.

Some states exempt payroll tax on the wages paid to apprentices, while others do not. Each state has a general exemption level but this level varies between states. Employers need to register and pay payroll tax.

It is assumed that small bakeries will have the technology to be able to keep all of the records and information required by Government, however often this is not the case and many of the records are still done manually.

### ***Recommendations***

7. That the Productivity Commission recommends that the Government establish one single tax, which is a percentage of turnover, which will cover all taxes required to be paid by small retailers and minimise the reporting processes required by small retailers. The collection agency of the one tax for small retailers can act as a clearing house to distribute the relevant taxes to the various bodies.

## **7.0 Any other regulatory or policy issues which impact on structural change in the sector**

Food Standards Australia New Zealand (FSANZ) passed legislation for the mandatory addition of folic acid and iodised salt within bread. The compulsory fortification of bread products was intended to reduce the risk of birth defects resulting from folic deficiency as well as address the prevalence of iodine deficiency found amongst the general population.

For the Government to impose folic acid into bread raises concerns as each individual's consumption patterns vary. Not only do individuals vary on the amount of bread that they are consuming in any day, but their other dietary intakes vary including their supplementation of various vitamins. Limited research has been undertaken as to whether there is detrimental affect on the individual if they overdose on folic acid.

It is interesting to note, that while FSANZ passed legislation for this to be a mandatory addition, New Zealand have amended theirs to make it voluntary and Canada, who also were looking at folic acid addition to bread, have moved away from this type of legislation.

During 2010, sodium reduction targets were set during the Food and Health dialogue facilitated by the Federal Government and the Australian Food and Grocery Council; these required manufacturers of both branded products and private label items to reduce sodium levels to 400mg per 100g by the end of 2013.

Whilst NBIA do not dispute the food and health targets on sodium reduction we are concerned that the Government's intervention in food is reducing consumer choice.

### ***Recommendations***

8. The Productivity Commission recommends that the Government should perform further research into whether an over-supplement of folic acid can result in any detrimental affect on an individual.
9. That the Productivity Commission recommends 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.

## **8.0 List of Recommendations**

1. The Productivity Commission recommends that the price fixing legislation be enhanced to ensure that the dominant markets can not concurrently discount the price of bread and baked products below relevant cost.
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3. That the Productivity Commission looks at introducing export assistance to Bakeries to develop overseas markets.
4. That the Productivity Commission recommends changes in the Training Packages for Bakers to address the five identified main areas of skill deficiency outlined above.
5. The Productivity Commission should recommend that the Government fund more research and development into improvements in energy efficiency for the Baking Industry.
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