

Australian Newsagent's Federation Ltd
Further Submission to the
Productivity Commission

Inquiry into the Market for Retail Tenancy
Leases in Australia

February 2008



INTRODUCTION

The Australian Newsagents' Federation (ANF) is the peak industry body representing newsagents in Australia. The ANF's membership comprises some 2,100 newsagents Australia wide. Nearly all ANF members are small business employing less than 20 staff.

The ANF reviewed the Shopping Centre Council of Australia's (SCCA) submission to the Productivity Commission Inquiry into The Market for Retail Tenancy Leases in Australia. The ANF noted that the Productivity Commission included a number of references from the SCCA submission in its Draft Report, further emphasising the view put forward by the SCCA. This submission to the Productivity Commission attempts to analyse and addresses some of the arguments raised by the SCCA.

PREAMBLE

The ANF notes that the SCCA in its submission characterises the voices of small business as emotional, inaccurate and unreliable; utilizing anecdote rather than evidence to influence public policy. Instances exist where such characterisations are not unfounded; however the use of broad generalisations to depict the representations of small business is misleading. In this respect we refer the Productivity Commission to the auditable case study examples provided by the ANF in earlier submissions.

Further, the relative advantage the SCCA enjoys with respect to resources and information in the formulation of its submission epitomises the relationship between shopping centres and small business. In spite of superior levels of resourcing, the SCCA is not above indulging in the use of anecdote and narrative when it is convenient in promoting their position.

The apparent or lack of a substantial body of evidence presented by the representatives of small business does not itself establish or support a case against the views put forward by small business but rather, demonstrates the broad nature of the issues and the endemic lack of resources available to small business to assemble the relevant facts. Consequently, the majority of the evidence on this matter rests on the side of SCCA and the shopping centre owners & managers who, through their superficial promotion of perceived economic efficiency in the retail tenancy lease market have appeared to have discovered a sympathetic audience in the Productivity Commission through its Draft Report.

The ANF feels that the approach and explanations outlined in the SCCA submission and the Productivity Commission Draft Report have largely ignored the normative economic arguments underpinning the value of small business to the fabric of the economy and the diversity of the Australian retail sector in favour of a normative value system more rigidly focused upon the outcomes of pure economic efficiency.

The ANF is aware of the dearth of information capable of clearly illustrating the detailed operation of the market and the very great need to ensure that future legislation is effective, appropriate and measured in its response. These factors may be accountable for what we consider is the misplaced view set out in the Commission's Draft Report emphasising economic efficiency at the cost of small business.

The Draft Report outlines the Commission's intention to use economic efficiency as a principle to guide future change, but we note that the Draft Report does not (perhaps wisely) offer any specific definition regarding what criteria in this market constitutes economic efficiency.

In this matter, the ANF recognises the evidence presented by Mr Steven Spring the representative of the Council of Small Business Organisations of Australia (COSBOA) in identifying a number of prevailing circumstances which prevent the market attaining economic efficiency.

The ANF, however, in this submission attempts to provide an alternative view of both the market for 'specialty retailers' in addition to some of the arguments set forth by the SCCA.

AN ALTERNATIVE VIEW OF THE MARKET FOR 'SPECIALTY RETAILERS'

The ANF considers that a valid argument can be made for the presence of monopoly characteristics within the market for specialty retail space in shopping centres, particularly within the context of a local or suburban retail market. It is the case that shopping centres tend not to be located within close proximity of one another and as such shopping centres often dominate local retail real estate markets and consumer shopping habits.

The positioning of shopping centres and their affect on local retail markets and retail real estate markets existing in local strip shops and high streets gives rise to the notion that specialty retail space in shopping centres lacks close effective substitutes within a confined suburban or inter-suburban geographic area.

The introduction of a shopping centre development into a geographically confined retail market was identified by the UK All-Party Parliamentary Small

Shops Group in its 2006 report "High Street Britain: 2015", as adversely affecting on the level of consumer spend in urban town centres and often resulted in "a gradual deterioration through a loss of footfall".¹ The report continues, recognising the impact of decisions by local planning authorities in allowing the development of new retail sites on small retailers stating:

"Planning developments have left small retailers severely disadvantaged, since decisions taken have had adverse effects on traditional retail districts. For example, the planning policy of councils has reduced footfall, thereby reducing the attractiveness of high streets for retailers to invest in"²

Arguably the effect of introducing a shopping centre into a local retailing environment can be the potential change in the nature, quality and consumer characteristics of the pre existing local retail space. The contention by the SCCA in their submission that planning laws "do not advantage one segment of the market (shopping centres) over other retail formats"³ does not adequately consider the unintended effect of planning decisions in altering the retail environment. Further, the Commission's draft finding found that "zoning and planning controls affect the location, quantity and use of retail space"⁴ potentially limiting competition and exacerbating the dominance of shopping centres in local areas.

If the effect of a shopping centre's introduction is sufficiently severe on the character of the surrounding retail space, then it is unlikely that small specialty retailers will be capable of obtaining a locally available effective substitute.

The SCCA submission admits the limitations placed on the development of shopping centres by planning policies through the location of shopping centres within designated urban centres serviced by public transport nodes⁵. The result of which, as mentioned earlier is the consequent isolation of the individual shopping centre as the dominant power of the local retail environment.

The impact of the shopping centre on the locally available alternate retail formats and the effect of zoning controls in limiting competition places the shopping centre managers in a position as the principal supplier of effective retail floor space.

The majority of the information and disclosure requirements are prescribed through various pieces of legislation and are primarily concerned with enabling transparency and the smooth operation of the lease, yet the current legislation

¹ House of Commons All-Party Parliamentary Small Shops Group (2006) "High Street Britain: 2015" p.24.

² Previously cited p. 17, 41.

³ Shopping Centre Council of Australia (2007) *Submission to the Productivity Commission Inquiry into Retail Tenancy Leases in Australia* p. 24.

⁴ Productivity Commission (2007) Draft Report *The Market for Retail Tenancy Leases in Australia* p. 60.

⁵ Previously cited, p. 77.

still does not address the key concerns that widespread information asymmetry exists between landlords and independent small business specialty retailers.

The chief issue of concern encompasses the extent of information asymmetry between specialty retailers and landlords during the negotiation of leases. Lease conditions that require specialty retailers to provide shopping centre managers with sales turnover information contribute to the widespread situations of information asymmetry between tenant and landlord during lease renegotiation.

The question of the fairness of this practice are separate matters for consideration. Central to the contention of the apparent information asymmetry is the cost, availability and accessibility of the relevant lease and rent information for specialty retailers within various jurisdictions around Australia; and the impact of these conditions upon the specialty retailer's ability to make informed decisions in assessing the 'market rent'.

The SCCA in their submission observes the ability of national and state chain retailers and major franchisors in managing their lease negotiations through in-house property departments⁵. We note that independent small retailers are subject to the same responsibilities as these larger competitors during lease negotiation, but lack the appropriate expertise and resources to adequately fulfill obligations of due diligence. In those jurisdictions where the registration of leases is possible, costs exist in registering and accessing the lease and rent information available.

The presence of a growing number of tenant advisors within the marketplace alleviates, to some extent, the divergent capability of shopping centre landlords and specialty retailers to access and act upon the relevant information. However, the existence of commercial lease advisors and of 'mandatory' lease registers in NSW, Qld and in both Territories⁶ does not fully address the issue of information asymmetry which still exists between shopping centre landlords and the majority of independent small business specialty retailers in the market for shopping centre floor space.

It is generally accepted that the retail real estate product offered to specialty retailers and anchor tenants and the markets for that floor space are substantially different. The SCCA states in its submission that anchor tenants perform a different role by providing pre-commitments for floor space and attracting customers ('pulling power'), two factors directly responsible for designation of areas within shopping centres for Discount Department Stores (DDS) and/or Supermarkets. In contrast to the highly concentrated market for large scale tenants, the market for specialty retailers within shopping centres is characterised by a large number of buyers engaged with a principal supplier for the remaining retail floor space.

⁶ Previously cited, p. 32.

From the perspective of the individual specialty retailer, shopping centre managers are in a position to exert a degree of control over the quantity within the market for shopping centre specialty retail space. Centre managers often exercise their prerogative to maintain a specific 'tenancy mix' within a centre to control the availability of retail space to individual retailers. Alternatively, provisions within standard lease agreements offer centre managers the option to displace retailers in the event of a centre refurbishment or demolition.

The operation of market forces that the SCCA submission⁷ contends occurs through the 'good faith' negotiations between a seller and buyers does not adequately explain the extent to which shopping centre managers are able to exert control over prices within shopping centres. A number of factors which influence the degree to which shopping centre managers are able to exert significant market power over the supply of specialty retail floor space in shopping centres are;

Firstly, shopping centre managers are aware of the limited mobility of independent small business specialty retailers in successfully relocating their business. The costs associated with relocation are particularly pronounced for independent small retailers as they are less able than their larger competitors to absorb the costs of relocation, refurbishment, time spent not trading and possess a reluctance to abandon 'supposed' goodwill from an established business. In addition, astute retailers and advisors are aware of the location based risks associated with relocating. In many instances, alternative location characteristics do not adequately suit the retailer's product offering adding to mobility difficulties.

Particular categories of retailers operate business models which require a large amount of footfall, particularly in the case of impulse purchase retailers such as juice and donut bars, further limiting retailer mobility in limited examples. While some retailer types are able to relocate to locally available alternate retail formats easily such as hairdressers with an established clientele this may not always be possible for other retail business.

Instances often occur when other shopping centres are too distant or issues of 'tenancy mix' prevent similar competitors from entering other shopping centre lease markets that are occupied with similar product offerings. As a result, the bargaining power of independent small business specialty retailers is constricted by its inability to readily enter and leave available markets for shopping centre retail space.

Secondly, the very nature and location of shopping centres are restricted through various local planning, demographic and financial criteria and requirements of planning authorities and centre developers; greatly limiting the number of shopping centres within any given local area. The strictly limited supply of shopping centre floor space within the confined geographical area of a local retail

⁷ Previously cited, p. 48.

market is a major determinant of the price of shopping centre floor space. Such an area is loosely defined but would conceivably be limited to the range of the local public transport network and may include a number of other retail formats. Consequently, claims by the SCCA in its submission⁸ of the affect of the general national growth in shopping centre numbers in over the previous six years and the "constant increase in supply of retail space for lease" potentially has little influence on the prices and ongoing operation of local markets for specialty retailer leases within established shopping centres. If the supply of new centres brought 'on-line' is too distant or the demographic characteristics are unsuitable it is likely to have a smaller effect on the retail lease market in a given local area.

The recent and prolonged expansion of national shopping centre floor space supply can be characterised as response to or 'catching up with' demand, particularly given recent low or "compressed" vacancy rates tabled in the SCCA submission⁹. Statements made by the SCCA in their submission¹⁰ such as "Competitions among landlords bestows bargaining power to tenants" and "intense competition between individual shopping centres for tenants", seems somewhat incongruous with the impaired mobility of independent small businesses in this market, the stated national growth in shopping centre floor space and the potential for continued expansion of retail floor space. These statements appear only to apply to the larger scale tenants within shopping centres.

Thirdly, the market for specialty retail space within shopping centres is characterised by a single supplier engaged with many specialty retailers. It is without question a major determinant of specialty retail floor space price within a local shopping centre market and significantly enhances the bargaining power of shopping centre managers in the above context.

A final and significant determinant of the supplier's ability to exert substantial control over the market for specialty retail floor space within shopping centre is the presence of any information asymmetry between landlord and specialty retailer. The ANF is disappointed the Commission's Draft Report does not accept that a "lack of information has placed significant efficiency constraints on the market"¹¹ weakening the case for government intervention in the provision of information, albeit the Commission has identified a number of potential improvements in the area of information and disclosure. In relation to shopping centres the Commission has said,

"If there were particular information-related problems it would be expected that the renewal rates would be low and the vacancy rates high – prospective tenants would see business in these retail concentrations as too risky".¹²

⁸ Previously cited, pp. 50-51.

⁹ Previously cited, p. 52.

¹⁰ Previously cited, pp. 50-51.

¹¹ Productivity Commission (2007) Draft Report *The Market for Retail Tenancy Leases in Australia* p. 161.

¹² Previously cited, p.148.

The ANF believes that this view relies on certain assumptions concerning the rationality of prospective independent small retailers and their ability to process available information and properly assess the risks and likely rewards.

Lease negotiations in reality more often reflect those preferences of information rich landlords who are more able to 'get away with it' rather than the free interaction of forces of supply and demand. It is the ANF's contention that the market cannot be said to be efficient unless the information asymmetry between small business retailers and shopping centre landlords is addressed and markets made clearer to prospective specialty tenants. Only then do we believe that the issue of respective bargaining powers may be addressed.

Shopping centre retail leases, in addition to traditional property rights, contain accompanying elements not often present in normal retail leases including management provisions and obligations similar to franchise agreements and management contracts. As a result, shopping centre managers are in a position to micro manage retail businesses through a series of predetermined key performance indicators. For those retailers relocating to a shopping centre from other retail formats the impact of these additional obligations is often unclear.

The number of disclosure and information provisions is testament to the notion that availability of information does not guarantee that it will be accessible for the majority of specialty retailers.

Readily available information can greatly reduce the occurrence of high retailer turnover or 'churn' and the practice of 'liar leases' (a lease entered into by a landlord in the knowledge that the tenant will be incapable of servicing the lease). It is conceivable that a level of demand that greatly outstrips supply could account for reported low vacancy rates and it is important to note that the low vacancy rates do not provide any indication of the reported level of stress upon incumbent shopping centre tenants. With respect to "renewal rates" (or more accurately the offering of new leases) the SCCA submission states,

"This table [Table 5] shows, in any given year, the proportion of retailers which were in the same centre the previous year. This demonstrates that, in most years, 85% or more of the retailers in shopping centres were also in the centre in the previous year"¹³.

If one uses the same assumption as SCCA of an average lease term of 5 years, and assume also that the majority of lessees remain until the expiry of their leases, then on average approximately one fifth or 20% of leases in a shopping centre fall due for renegotiation in any given year. If 15% of leases are not renewed in that year, this represents a much larger proportion of those leases seeking renewal and could be characterised as "churning" in a climate of high demand for specialty retail shopping centre floor space.

¹³ Previously cited, p. 56.

The ability of shopping centre landlords to exert control over prices in the local market for specialty retail shopping centre floor space through their position as principal seller, knowledge of small business mobility, superior market knowledge and limited local supply, presents another factor that suggests a monopoly market structure within this market. The ultimate effect of which will be subject to the capacity of retail tenants to pass on costs in customer prices.

A market characterised by many buyers and a single supplier capable of exerting a significant degree of control over prices and to a lesser extent quantity, the lack of an effective locally available close substitute and information asymmetries varying levels of information asymmetry between buys and the supplier suggest the possibility of a monopoly market. This situation is made possible by a number of factors related to the limitations of independent small business retailers and the localised and highly polarising nature of shopping centres and their effect on their immediate retail environment.

In the above situation the shopping centre monopolist would view the marginal benefit of its actions differently than either specialty retailers or consumers. Much of what is currently subject for debate concerns the ability of shopping centre managers to successfully pursue courses of action which maximise their marginal benefit.

If a thesis outlining the existence of a monopoly within the local market for shopping centre floor space for specialty retailers were accepted, earlier normative notions of economic efficiency used to guide regulatory policy would dictate radical changes to the current retail tenancy regulatory regime in the interests strengthening market competition.

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