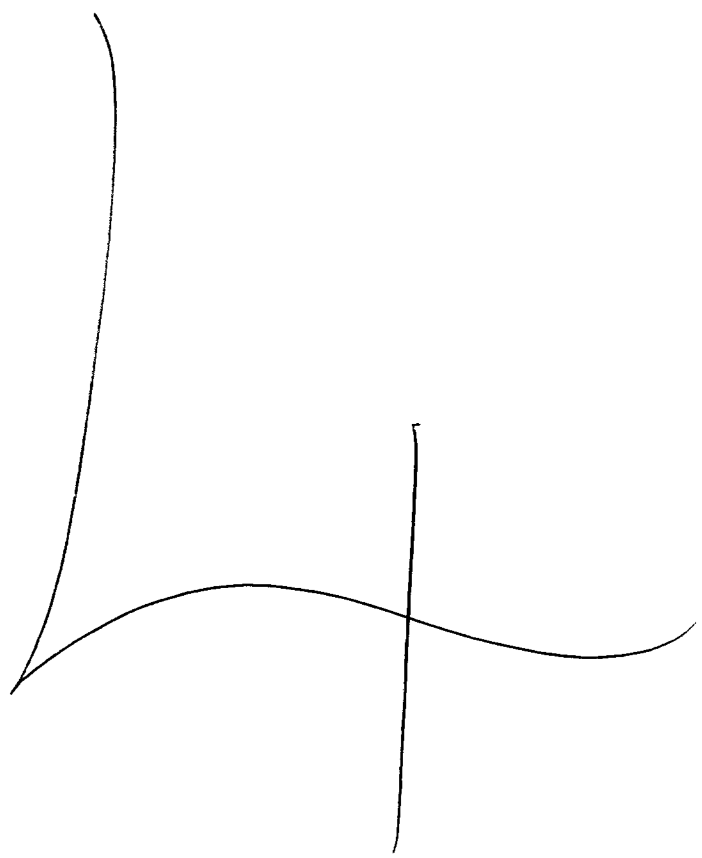

SUBMISSION TO THE JOINT SELECT COMMITTEE ON THE RETAILING SECTOR

prepared for

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by

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1. Background

1. A Joint Parliamentary Inquiry into Retailing was established to meet a commitment made during the last federal election. It is intended to address concerns relating to industry concentration in the retail sector, and in particular the food and grocery segment of this market. It is also a response to the interest all political parties have in the performance of small business and the provision of services to rural and regional areas.

2. At the last retail census in 1991-92 there were approximately 173,000 shopfronts in the total retail sector, of which 9,486 were supermarket and grocery outlets. In the six years prior to that census the number of grocery and supermarket outlets had decreased by 1,007 (or 10%) whilst specialised food retailing had increased by 3,198 stores over the same period.

3. The scarcity of more recent data precludes us from drawing too many conclusions other than to say that these trends are continuing. The decline in grocery and supermarket store numbers is a world-wide phenomenon due to the growth in the scale of store required to meet modern customer requirements of range, choice, price, access and convenience.

4. Governments throughout Australia are interested in maintaining a dynamic small business sector - including small retailers. The small business sector accounts for the vast majority of individual businesses in terms of numbers and is important in broader measures of economic activity, because it accounts for over 44 per cent of total employment and around one third of industry gross product. The sector accounts for nearly 34 per cent of wages and 42 per cent of the profit share. Of the 900,000 small businesses trading in Australia in 1996-97, around 18 per cent of them are operating in the retail sector (Australian Bureau of Statistics (ABS), 1321.0). Of these, 41 per cent are non-employing small businesses.

5. **Businesses classified as medium or large are even more important in terms of production and contribution to employment, wages and profits, but for the most part have been of less concern to policy makers in recent years.** The present Inquiry is focused on retailing and follows Inquiries on the adequacy of financial flows to the sector, retail tenancies and the impact of the regulatory burden imposed by governments.

6. In 1997, the House of Representatives Standing Committee on Industry Science and Technology prepared a report on *Finding A Balance: Towards Fair Trading In Australia.* This report covered a number of topics, but looked in particular at the power of major shopping centre owners and managers and the way that power might be used in dealings with small retail tenants. Regulation of retail tenancies is the prime responsibility of each State and Territory but the Commonwealth has issued a set of minimum retail tenancy standards in its *New Deal: Fair Deal* reform package. The Commonwealth is working with the State and Territory Governments to implement a set of principles consistent across Australia. The current Inquiry is not expected to revisit the issues addressed in the previous report.

7. During the October 1998 election campaign, all the major political parties outlined policies for small business and each commented specifically on the retail sector. Largely in response to pressure from a group called the National Association of Retail Grocers of Australia (NARGA) the political parties promised an inquiry into retailing. Terms of reference for a Joint Select Committee were agreed in December 1998. They were:

> "That a Joint Select Committee on the Retail Sector be appointed to inquire into and report on :

(a) the degree of industry concentration within the retailing sector in Australia, with particular reference to the impact of that industry concentration on the ability of small independent retailers to compete fairly in the retail sector;

(b) overseas developments with respect to this issue, highlighting approaches adopted in OECD countries; and

(c) possible revenue-neutral courses of action by the Federal Government (ie courses of action that do not involve taxation reform)."

8. The media release announcing the 16 February 1999 meeting of the Select Committee noted that the Inquiry will include:

> *an examination of the purchasing practices of the major retailers, especially those relating to purchases from primary producers.*

More generally, there has been considerable interest in the changing nature of retailing and the way competitive forces work within the industry. As discussed below, retailing covers a broad range of activities and in an economic sense it is not easy to differentiate among those that range from the sale of household furniture and white goods through to hardware products, restaurants and the sale of fresh foods and groceries.

9. When interpreting the committee's terms of reference, the particular concept of retailing employed is crucial. The Australian Bureau of Statistics' definition of retailing covers a broad range of activities involving the sale of goods and some selected services to the public. Retailing by this definition accounts for approximately 44 per cent of total private final consumption expenditure, including wholesale trade, about 11 per cent of GDP, and 15 per cent of total employment.

10. The simplest distinction is between food-retailing and non-food retailing. Food is the more homogeneous grouping but still covers a broad range of activities (Table 1-1 below details a total expenditure of **$77,260 million in 1998**). This approximates to the industry's own **share of stomach** concept, which measures all food bought from establishments as diverse as restaurants, fast food outlets and convenience stores, as well as food and vegetables in various states of preparation and the entire spectrum of dry groceries purchased at retail stores. Many of the comments made about retailing in the context of the current inquiry will concern dry packaged goods only. While significant, it should be remembered that these goods represent less than half (some $33 billion dollars in 1997-98) of the share of stomach concept outlined above and are only part of a broader retailing industry in Australia.

Table 1-1: Annual Food Sales by Sector

	1983		1990		1997		1998	
	$m	% share	$m	% share	$m	% share	$m	% share
Supermarkets / Grocery	12,825	46%	23,566	46%	36,575	50%	38,763	50%
Takeaway	2,533	9%	5,104	10%	7,579	10%	7,184	9%
Other Food Retailing	3,653	13%	6,391	13%	9,040	12%	10,187	13%
Hotels & Clubs	6,779	25%	10,963	22%	13,281	18%	14,130	18%
Cafes & Restaurants	1,856	7%	4,664	9%	6,618	9%	6,996	9%
TOTAL	**27,647**		**50,689**		**73,093**		**77,260**	

Source: ABS 8501.0, Table 3.

11. Given the breadth of retailing, there is a degree of arbitrariness involved in selecting out given segments of the industry when a wide range of goods competes for the family budget and can be bought at the same outlet or shopping centre. The approach in this submission will be to start at the broadest level of retailing and then focus on food retailing, still as a whole, before discussing specific issues relating to the sale of dry groceries and fresh foods.

12. Overseas experience in retailing is seen as relevant to the Inquiry both in terms of learning from the way the retailing industry has developed elsewhere and from experience with policies directed at influencing the industry. Retailing is affected by many factors including income levels, the age and composition of the population, modes of transport, technology, and the overall size of the economy, as well as a number of social and cultural influences. Because a country's stage of economic development is formative, comparisons with other industrialised countries make most sense, but even within that group there will be some whose experience is more relevant to Australia than others. If lessons are to be drawn from the overseas experience it is vital to obtain comparable data and to be aware of differences in coverage and definitions between data sets.

13. The terms of reference of the Joint Parliamentary Inquiry require that any regulatory proposals impacting on the retail industry should be revenue-neutral. This is intended to avoid a conflict with concurrent inquiries into aspects of the taxation system, while the debate on the introduction of a Goods and Services Tax (GST) will cover sales tax issues that may be of concern to the retail industry. Revenue-neutral should mean neither adding nor subtracting from overall revenue collections by government. However, it needs to be recognised that there are some regulatory proposals, which, although not directly involving tax changes, may affect revenue collections, if they have a significant impact on economic activity. In addition to the potential impact on government revenues, it is thus important to consider the effect such proposals might have on the efficiency and profitability of the retail industry, the welfare of those who are employed within it, and the welfare of its customers.

2. Theoretical background

It is not possible to have a fixed notion of the appropriate level of concentration of businesses within any industrial sector. The efficiency of a sector depends on:

- *the legal and institutional framework;*
- *the costs of larger scale production and distribution;*
- *management skills and the size of the market; and*
- *consumer demand.*

The structure of any industry needs to be flexible enough to respond to changes and open to entry of new competitors who might bring improvements in products, technology and management systems. Barriers to entry into retailing in Australia are generally low.

Concentration is not necessarily a sign of a lack of competition. Size itself does not guarantee firms a continued profitable existence.

There are important changes to the nature of retailing taking place in most of the industrialised countries and they are having an impact on the nature of the industry in Australia.

All markets require a legal framework that defines and enforces property rights, and facilitates trade, but they should generally be free of direct regulatory oversight. Part of that framework is the product of deliberate legislative intervention, such as Trade Practices legislation but part of the structure has occurred naturally through custom and common law.

Regulation can improve market outcomes, but if used inappropriately can discourage competition and protect some firms at the expense of the community in general.

14. Australia has a relatively high degree of retail industry concentration compared with other developed countries. This Section examines some of the economic factors leading to the concentration of industries.

2.1. Economic determinants of firm size and industry concentration

15. Objective analysis suggests that in any economy there are likely to be firms of varying size. The range of sizes will depend on many factors, including the nature of the goods and services supplied and the technology used in production and distribution. Improvements in transportation, for example, have generated economies of scale in many areas, including retailing, but higher incomes have also generated a demand for products and services that meet individual tastes, thereby opening up niche markets.

16. Business structures that particular activities support will also change over time. For example, Australian exports were once dominated by small rural producers of a narrow range of commodities but the growth in the mining sector and the changing competitive position of the manufacturing and services sectors of the economy have substantially altered Australia's reliance on and exposure to rural producers.

17. The number and structure of firms in an industry can ultimately be traced back to the costs of production, both the internal costs of organising production and the costs of physical production and distribution. The most appropriate structure for an economy is likely to be a range of firms of all types and sizes.

2.1.1. *Firm size*

18. The "firm" is a unit of production. It can range from an individual providing labour services to a multinational company operating in many locations. The distinguishing characteristic is the existence of a single overarching decision process that determines production/output in response to market prices.

19. There are many factors or economies of scale and scope that influence the size of an efficient firm. These include:

- Transactions and agency costs;
- The legal and institutional structures governing labour contracts;
- The nature of technology, including those enabling communications within and between the various locations over which a firm's operations are spread; and
- The ideas and practices of management.

20. As these factors and the relationships between them change so too will the size of the efficient firm. This, together with demand conditions, will determine the number and sizes of firms supplying a given market.

2.1.2. *Industry structure*

21. The ideal competitive market should contain a sufficient number of buyers and sellers in order that no one participant is able to influence the price or terms at which trade occurs. In a stylised competitive firm the average costs of production (supply) follow a "U" shaped curve. Per unit costs initially decrease with increased output as the fixed costs of the business are spread over larger volumes of sales, but eventually they increase with the rising costs of variable inputs (including managerial skills and the costs of coordination and communication within the firm). The point at which these forces balance indicates the minimum average costs of supply, and the efficient scale of the firm. An industry comprised of a large number of such firms will tend to have a long-run supply price at this minimum average cost. Higher prices will generate profits for existing firms, attracting new entrants and competition that drives down prices. Conversely, losses associated with low prices can mean some firms leave the industry, removing an amount of production (and supply) thus allowing prices to rise to cover costs.

22. In practice, there will be a variety of firms with different costs, reflecting the variety of managerial and production skills of people working in the industry and a range of costs associated with different production and managerial methods, sources of inputs, transport distances, means of distribution, etc. The long-run price will just keep the marginal firm in the industry, and will yield better returns to the more efficient competitors.

23. Other things being equal, the higher the proportion of fixed costs relative to total costs, the greater the efficient scale of production. The number of firms needed to supply demand by producing at the minimal cost level will decrease, and lead to concentration within the industry. If average costs are still decreasing when a single firm supplies all of demand, the market is a natural monopoly.

24. Because the factors that determine the efficient scale of production and the level of demand are unlikely to be constant over time, the number of firms supplying a given market and the concentration ratio of the industry will also change. If the efficient scale of production fluctuates but remains relatively small the industry stays dispersed. There will be a steady turnover of firms with entry and exit ensuring that only the most efficient will be in existence at any one time. But if the minimum efficient size of firms is raised by changes in methods of production, firms will necessarily coalesce into larger units.

25. The dynamic processes of different industry structures will produce a variety of competitive outcomes, including price, and behaviour in the markets. Multi-product firms can spread fixed costs over a number of products and compete on the breadth of their "offer" to consumers. Efficiency will depend on the balance between the additional demand that the greater variety attracts and the costs (stock monitoring and the loss of economies of scale on individual items) of carrying or producing more products.

26. In retailing, the "offer" also encompasses services not sold directly to customers, such as the availability of parking, ambience of the store, staff expertise or knowledge of the features of the products sold as well as the proximity of other, possibly competing, retailers. Such factors will influence the time and search costs of shopping, and could equally be considered as part of the total price of the goods and services purchased, instead of as part of the bundle of goods itself. A shop with convenient parking offers a more attractive package than an otherwise identical shop without parking.

27. Geography strongly influences the retail market structure by determining the level of local demand relative to costs. The time and transport costs of purchasing from distant sources will affect the demand for locally produced and distributed goods and services, and this, in turn, will influence the concentration and composition of local supply. These costs will also influence the incentives for buyers to visit a single large shopping centre instead of a number of smaller and dispersed specialty stores.

28. All these factors combined with population density will mean that the supply of goods and services in regional markets will tend to be more concentrated than supply in metropolitan areas. That is, while the costs of establishing and operating firms (shopfronts) in regional centres (and therefore the minimum efficient scale of supply) might be comparable with that which applies Australia-wide, relatively small local demands may only sustain a small number of efficiently-sized retailers. While a metropolitan area may have the same number of suppliers as a regional market with a similarly sized population, the number of readily available alternative sources of supply will be smaller for the latter. It is a natural consequence of the costs and technology of retailing that the measures of concentration of local supply to small, isolated populations will tend to be higher than for metropolitan markets, or the economy as a whole.

29. Although cost and demand conditions play an important part in determining the concentration of supply in retail markets, concentration by itself is not a good indicator of the effectiveness of those markets in satisfying the demands of their customers. Recognition of this fact is the basis of s.46 of the amended *Trade Practices Act 1974*, which prohibits the misuse of market power, but not the possession of such power. As made clear by the British Office of Fair Trading (OFT, 1997), there are far more dimensions to the performance or competitiveness of a market than the degree of concentration of ownership.

2.2. Efficient market structure

30. Market structure is a term which refers to the number and relative size of the firms that supply a given range of goods and services. Although structure was used as a guide to

market efficiency in the past, modern economic theory recognises that concentration by itself is not an adequate indicator of the likely performance of a market. Other factors, including access to essential factors and facilities, the openness of the market (ease of entry and exit), and the strategies adopted by the suppliers themselves are all important influences on the ability of incumbent firms to obtain excessive returns (rents or monopoly profits).

31. Efficient markets use the lowest cost combinations of factors of production (land, labour and physical and financial capital) to deliver the highest value goods and services to final consumers. Competitive markets tend to generate efficient outcomes because individual firms need to minimise their costs and keep prices as low as possible in order to survive. Conversely, firms with market power may be able to raise prices to consumers, and retain excess profits or sustain costs above the level necessary to deliver their output[1]. A transfer of gains from consumers to producers results but some of those gains may be lost because less than the efficient quantity of goods or services is traded.

32. Although more competitive outcomes are usually associated with a larger number of suppliers, the reverse does not necessarily apply. A market with a small number of suppliers usually generates "competitive" outcomes, in the sense that it delivers the types and quantities of goods and services customers want at the lowest possible prices.

33. Concentrated and dispersed industry supply have advantages and disadvantages. A dispersed industry will react to widespread increases in costs through falling profits in the short-run and then exits and higher prices in the long-run. Conversely, an industry composed of a small number of large firms may be able to preserve aggregate profitability by adjusting prices more quickly, but will nevertheless make the same type and degree of adjustments that the dispersed suppliers would have in the long-run. In one case the market is required to send the signals needed for adjustment, in the other the adjustment comes from the conscious decisions of the managers in a small number of firms.

34. Competitive markets generally produce efficient outcomes, but they cannot guarantee "fair" outcomes in the sense of reallocating goods and services to meet any particular equity goal. "Fairness" in this redistributive sense is an issue that governments address through the taxation and transfer system. Competitive markets are nevertheless fair in the sense that they allow individuals and firms voluntarily to buy or sell where they believe it is to their advantage to do so. No one is forced to buy goods at a price above the value they place on them, and no seller is forced to trade at a loss.

2.2.1. Market structure and efficiency

35. Given the level of demand for their output, the number of firms in an industry depends importantly on the smallest efficient scale of operation for an individual firm where the firms are using best-practice technology. Baumol *et al* (1982) have shown that if the market is perfectly contestable, which is to say if existing firms are not protected from *potential* competitors, the resultant size of firm will be efficient regardless of the number of *actual* competitors, even in the case of a natural monopoly. Perfectly contestable markets are characterised by "ultrafree" entry and exit[2]. This requires that entrants do not have costs (such as sunk capital expenses, taxes and set-up costs) they cannot recover and have equal

[1] This "cost padding" can take many forms, including over-staffing, higher than market wages or other generous conditions, "gold-plating" of capital equipment, and fringe benefits for managerial staff. Publicly owned monopolies (railways and electricity and telecommunications utilities, for instance) were often prohibited from making explicit profits in the past, and their excess profits were frequently taken in these inefficient forms.

[2] See Berg and Tschirhart (1988), p.246-247 for a discussion.

access to production technology and consumers (i.e. customers are not bound to existing firms by long-term contracts). How these conditions are met will vary, but the hypothetical ideal provides a benchmark against which to test the performance of actual markets. The important point to note is that concentration itself is not the proper measure of market efficiency. A reduction in the number of competitors in a market does not automatically mean that the market has become less competitive.

36. The general nature of barriers to entry into retailing is discussed in detail by the British Office of Fair Trading (1997, Chapter 4):

> *barriers to entry into retailing tend in fact to be relatively low, although entry into particular* strategic *markets can be a lot more difficult than entry into* economic *markets.* (emphasis in the original)[3]

37. Data on the barriers to entry in the Australian retail industry are reviewed in Section 3.3 below. Retailing has few inherent barriers to entry at the level of individual products, and while the deterrents to entry are stronger on broader criteria, retailing is more open to new entrants, including from overseas, than other industries.

2.2.2. *Dynamic processes and the evolution of industry structure*

38. Although, as discussed in Section 3.2 below, Australian retail trade is relatively highly concentrated by international standards, the increase in concentration in recent years, and the factors to which this can be attributed, is common to most developed countries. These factors include:

- Improvements in transport and communications technology that have increased the relative efficiency of larger retail outlets;
- Sociological changes, such as the bigger proportion of women in the workforce, for whom shopping has a greater time-cost today, hence a preference for "one stop" shopping;
- Technological changes in the home such as microwave ovens, refrigerators and freezers that allow a greater range of fresh food or partly prepared meals to be purchased, stored and cooked;
- Increased consumer incomes and mobility (which permit more goods to be purchased during each shopping trip); and
- The increased importance of branded packaged goods.

39. The efficiency of competitive markets is preserved over time because competition ensures that firms respond to external changes such as the evolution of production technologies and product innovation, and influences on demand such as population growth through immigration and migration from country towns to metropolitan areas, and changing consumer preferences. Markets quickly become inefficient if firms are protected by regulation from outside influences. While this is most likely where there is a regulated monopolist, if restrictions on consolidation are introduced in otherwise competitive markets

[3] Economic markets are defined by reference to products (the uses and physical characteristics of the goods sold) and consumer reactions (the goods they consider complements and substitutes), whereas strategic markets take into account the strategic behaviour of retailers (which of their competitors' prices they react to) across both products and regions. A strategic market might therefore have two major suppliers, but ignore the smaller competitive fringe.

(with many sellers) inefficiencies may be created - but they may not be fully apparent until the barriers to adjustment are lifted.

40. One of the clearest indicators of an efficiently working market is the ability of new entrants or small incumbent firms to capture market share from larger, possibly dominant, rivals if the large firms fail to innovate or adapt quickly enough to change. Survival in competitive markets requires firms constantly to ensure that their products are low priced and of appropriate quality. Firms that become large without sustaining marketing and product innovation or keeping in close touch with customer preferences leave open niches that rivals can fill and their market position is likely to be challenged.

41. In contestable markets even a natural monopolist can be overthrown by a rival who is more efficient or offers customers a better range of prices or products. In practice, market share is not usually lost quickly (hostile takeovers aside), but a salutary threat is always present. The danger for dominant firms is failing to foresee or capitalise on technological advances. As an illustration from another industry, although IBM still has a substantial share of the market for business computing hardware and software, its position today is minute compared with what it was in the 1960s and 1970s. IBM's relative demise can be attributed to its failure to adjust quickly to the technological changes which IBM itself pioneered, but which reduced the scale of its product (from large mainframes to personal computers) and reduced the size of firms that could enter and produce them (IBM PC clones could be economically built even by individuals). By 1993, the company's annual net losses reached a record $8 billion. More recently its prosperity, if not its market share, has since been restored by concentrating on its strengths in large-scale and networked computers, and by expanding into associated software services.

42. To take the example of the passenger aerospace industry, there is still vigorous competition for customers in all countries, despite the trend towards globalisation and international business consolidation. The current dominance of Boeing and Airbus Industrie in the world passenger aircraft market is no guarantee of their long-term profitability or market shares. This is due, in part, to the existence of smaller competing manufacturers and the relative sophistication of their customers, but largely because of the rivalry between the two dominant firms. Likewise in the automotive industry, where economies are relatively open to imports, the degree of concentration in local car manufacturing has little bearing on the competitiveness of new car markets. Local manufacturers may have gained large shares of their home markets with the benefit of lower delivery costs and knowledge of local tastes but this does not protect them from overseas competitors. Australia experienced this in the last decade, when the rationalisation of the local car manufacturing industry has seen increased concentration of local production matched with increased competition from imports and substantial alterations in the market shares of the major producers.

2.2.3. *Efficient vertical relationships*

43. Just as cost factors determine the efficient scale of the firm, so too transaction costs influence the spread of a firm forwards and backwards along the chain of production of which it is a part. In the case of retailing this affects how far retailers involve themselves in "upstream" activities such as distribution, warehousing, transportation, production and importation.

44. Along with the rise in the efficient scale of retail firms and associated increase in industry concentration over the last few decades, the retail industry has also expanded its upstream activities. The retail majors, while still largely contracting transportation out to specialised companies, have saved costs by centralising much of their warehousing and

distribution. This has not only achieved savings from economies of scale in the activities themselves but also from the ability to coordinate sales and promotions of product lines centrally.

45. Just as concentration raises the possibility of abusing market power in final goods markets, it also opens the way for dominant firms to distort otherwise competitive upstream and downstream markets when it occurs at other places along the chain of production. In its extreme form, the market power of a single buyer (monopsony power) can create the same inefficiency as a monopoly seller. The single buyer restricts the quantity of factors bought (such as labour, energy and raw materials), lowering the price per unit paid to suppliers. This cuts the buyer's cost of sales by more than the revenue lost through the associated decrease in production (sales in the case of retailers) and leaves the buyer with a profit. Public welfare is reduced in the process because less than the competitive quantity is traded and not all of the potential gains from trading the factor are realised.

46. The conditions in which an incumbent firm can abuse buyer power are analogous to those required for the abuse of monopoly but are largely curtailed if there are no barriers to entry and exit. Any profit gained by accepting a lower margin on sales will attract the entry of rivals who can bid a higher price by being willing to accept a lower margin on sales. Thus firms in relatively open markets, whether these are concentrated or not, can be expected to compete not only for customers but also for inputs. Easy entry and exit means, however, that they will not be likely to abuse their apparent market power.

2.3. Economic rationale for regulatory intervention

47. Markets do not exist in a legal or regulatory vacuum. Even the ideal competitive market presupposes a legal framework that defines and enforces property rights, thereby suppressing disincentives for the production of goods for sale and ensuring that contracts between buyers and sellers are binding. As a result producers can be confident that they will be rewarded for their efforts. By shielding producers and consumers from deception and fraudulent behaviour, the legal system ensures a level of economic activity that generates benefits far in excess of the costs of compliance. The regulatory framework also serves to coordinate trades, reducing the number of matters that need to be regularly negotiated between buyers and sellers (as it does by imposing standard weights and measures, tax liabilities and the nature of title). Some of this coordination is the result of intentional legislation like the *Trade Practices Act*, but custom (such as the norm prevailing as to whether goods are handed over before or after payment) and common law have also played significant roles.

48. Beyond defining the rules of what constitutes "fair" market behaviour, governments can also intervene to prevent or mitigate more systematic failures of markets, such as negative externalities (pollution spillovers or the non-provision of public goods) and abuses of market power (monopolistic pricing accompanied by suboptimal levels of production or excess profits). There are also welfare issues that a government may take into account, like differences in the information available to sellers and buyers (for example the unverifiable quality of the goods offered or inadequate disclosure in insurance). Such issues, or a perception that the problems exist, have provided a rationale for regulation.

49. In addition to policies and laws that impact on market conduct and provide protection for customers, markets are influenced by a broad range of policy settings. The Productivity Commission (1998, Box 1.1) identified five important government–related sources of influences over market structure:

- Trade and investment liberalisation;

- Infrastructure and general government reforms (commercialising, corporatising and privatising public utilities);
- Labour market reforms;
- Competition and other regulatory reforms (such as through the National Competition Policy framework); and
- Taxation reforms.

50. With the exception of competition policy reform, most of these factors have not had the same direct influence over Australian retail trade policy in recent years as the external factors discussed in the previous Section. Nevertheless, each has tended to contribute to the long-term expansion of the scale of efficient retail firms. The larger and more recent impact of competition policy reform has come through the further impetus it has given to State and Territory governments to review, and in some cases relax, legislation governing trading hours.

51. Regulation can serve to improve market outcomes where some failure is evident - but it can also retard the growth of markets when applied inappropriately or sustained after changes in an industry have removed the justification for it. Deregulation may then have salutary effects. For instance, the substantial growth of the Australian financial services sector in the last two decades can be attributed to the deregulation in the early 1980s which allowed and encouraged entry into the market for banking services and the establishment or expansion of firms offering consumers alternatives to traditional financial products. While deregulation has contributed in some respects to an increased concentration of ownership in banking services, it has also provided opportunities for increased competition that would not have been possible under the controls. Depositors now receive interest rates that are closely aligned with commercial rates. Specialised mortgage originators (such as Aussie Home Loans and RAMS) have acquired a substantial share of the home loans market, using innovative financial instruments and ways of marketing that were unlikely to have been permitted in the previous regulatory regime.

52. Regulation which seeks to preserve or promote a particular industry structure for its own sake is most likely to create inefficiencies and reduce living standards for the population as a whole. The main beneficiaries from such intervention are firms that would otherwise be unable to compete in the unregulated market, because their costs are too high or they are unable to predict and fulfil their customers' demands as effectively as potential competitors.

53. Regulation can serve the public interest, but it may be abused in the pursuit of private interests, or it may inadvertently serve such interests at the expense of the community in general. In particular, "industry-wide" regulation may have the effect of hobbling some existing competitors, or potential competitors, to the advantage of other firms. Statutory barriers to entry, such as protected public monopolies over electricity, water, post and telecommunications, are one example of a type of regulation that benefits incumbent firms at the expense of potential rivals, and usually at the expense of customers too. Reforms to the regulation of these industries in Australia and in other countries in recent years have illustrated the benefits of allowing increased competition. As discussed in Section 4, one of the key parts of the microeconomic reforms agreed between Australian governments has been the review of all regulation that restricts competition in order to abolish any that cannot demonstrate a net public benefit.

3. Current structure of Australian retailing

Retailing or distribution is one of the largest sectors of the economy. It covers a diverse range of activities and accounts for around 11 per cent of GDP and 15 percent of total employment.

In recent years the sector has experienced strong growth in demand and employment. It is dynamic, with all the characteristics needed for vigorous competition, having a large number of competitors of all sizes and being characterised by ease of entry and exit. ***Profit margins tend to be low compared with other industries, both for smaller and larger stores.***

Economies of scale have contributed to the growth in the larger stores but the differentiated nature of the market has also seen growth in the number of smaller specialist retailers.

The present submission deals with food and grocery retailing. On the broad definition of where food and groceries are bought - the so-called 'share of stomach' measure - expenditure in the sector accounts for around 55 per cent of retail trade turnover. Supermarkets and grocery stores account for about 50 per cent of purchases, their share having increased marginally in recent years.

On some of the narrower definitions of the industry, the three largest retailers account for 80 per cent of the dry packaged goods market athough broader measures suggest the level of concentration is around 60 per cent.

In many categories of groceries and fresh food supermarkets accounts for considerably less. For example, Coles share of fresh milk is only 13 per cent of milk sold in Australia.

The larger stores operate on narrow margins, suggesting that any forced transfer of sales from large to small would come at the cost of higher prices for consumers.

54. This Section provides an overview of the retailing industry in Australia. Wherever possible, data are analysed separately for different categories of food retailers.

3.1. Overview

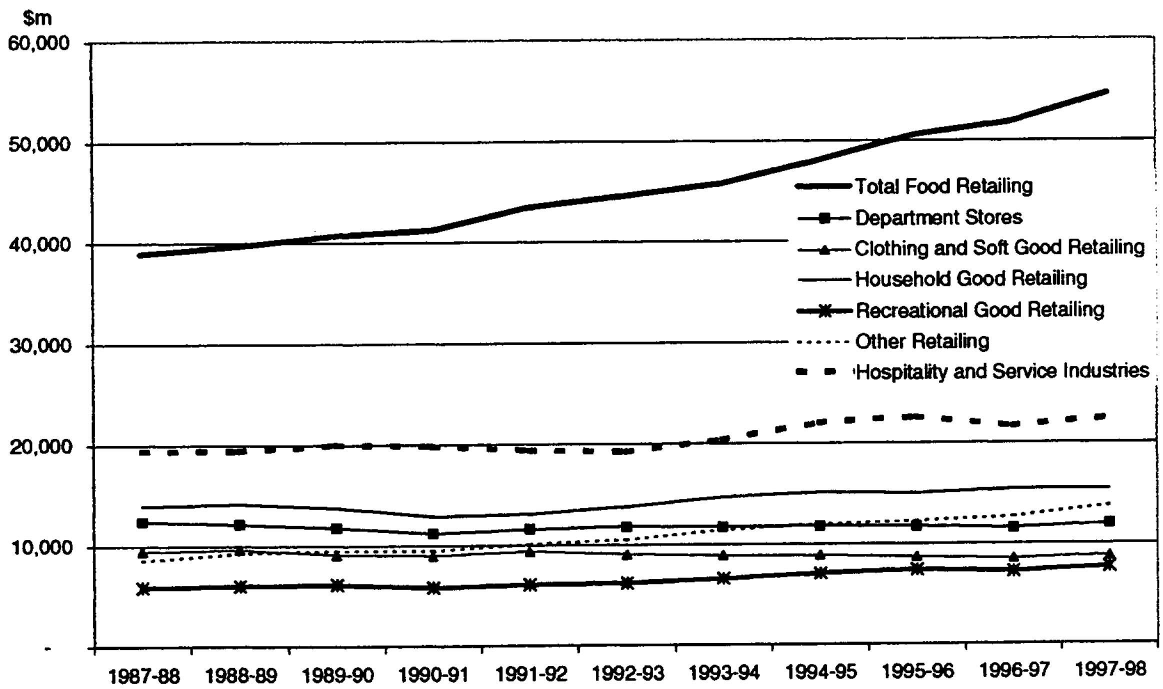
55. The retail industry is important in national output. Retail and wholesale trade accounts for about 11 per cent of Australia's Gross Domestic Product (GDP). As noted in the introduction, retail trade covers a broad range of activities involving the provision of goods and some selected services. The retail industry accounts for around 44 per cent of total private final consumption expenditure, and 15 per cent of total employment. A breakdown of retailing by type of activity in 1997-98 is given in Figure 3-1 below. Note that motor vehicle and associated goods are no longer included in the total, but that this component accounted for about 26 per cent of total retail turnover according to the 1991-92 Retail Activity Survey (ABS, 8624.0, Table 2).

Table 3-1: Real Retail Trade Turnover Summary ($m)

	1985-86	1991-92	1994-95	1997-98
Total Retail	**107,976**	**113,077**	**124,869**	**134,585**
Food	38,684	43,470	48,007	54,617
Supermarkets / grocery	26,203	29,616	32,933	37,405
Takeaway	5,214	6,352	6,800	7,435
Specialty Food Retailing	7,268	7,502	8,275	9,776
Department Stores	12,705	11,607	11,834	11,995
Clothing and Soft Good	9,688	9,342	8,856	8,765
Household Goods	14,087	13,146	15,125	15,391
Recreational Goods	5,663	6,060	7,040	7,622
Other Retailing	8,100	10,082	11,992	13,769
Hospitality and Services	19,050	19,370	22,016	22,428
Hotels and clubs	13,238	11,846	13,227	13,574
Cafes / restaurants	4,167	5,794	6,650	6,677
Selected services	1,644	1,730	2,139	2,177

Source: ABS 8501.0, Table 1; Access Economics, *Five Year Business Outlook* (Dec 1998).
Note: Prices are in real terms, adjusted by headline CPI to 1997-98 prices.

Figure 3-2: Real Retail Trade Turnover (1997-98 prices)



Source: ABS 8501.0, Table 1; Access Economics, *Five Year Business Outlook*, December 1998

58. The retail industry employed 1,218,000 persons in 1996-97 (with 40 per cent in food retailing), of whom just over 51 per cent were in small businesses (ABS, 1321.0, Table 1.2). Employment growth in the industry between 1983-84 and 1996-97 was 2.6 per cent per annum (ABS, 1321.0, Table 2.3). It even registered 6.8 per cent per annum between 1993-94 and 1996-97, which was above the all-industries average of 5.2 per cent (ABS, 1321.0, Table S3). During this period small retailers experienced slightly lower employment growth at 6.6

per cent per annum compared with all other retail businesses at 7.0 per cent per annum (ABS, 1321.0, Table S3). While the number of non-employing small retail businesses has fallen, small retail business with employees have increased strongly (ABS, 1321.0, Table 2.3). As of November 1998 more than 1.3 million people, of whom 54 per cent were full-time, were employed in retail trade. As shown in Table 3-2, the employment in Coles supermarkets has grown from 700 in 1928, to 53,000 in 1997-98.

Table 3-2: Coles Employment 1928 to 1998

	Total Employees
1928	700
1935	2,450
1949	4,600
1955	6,000
1965	14,000
1977	20,000
1985	44,200
1990	50,400
1998	53,500

Source: CML

59. The industry employs slightly more females than males. Some 44 per cent of all employees work part-time. The industry attracts a high proportion of casual employees (around 36 per cent) compared with other industries (DEWRSB, 1998b, Tables 4.6 and 4.10). In the early 1990s Coles had up to 70 per cent of its supermarket staff working on a casual basis. Since 1994 Coles has reduced this to 38 per cent (in 1998) with a goal of 20 per cent within four years.

60. Coles aside, the high level casual employment in retailing generally is reflected in the high level of job turnover (see Table 3-3). (In the table large businesses are those with 100 or more employees, whereas small and medium enterprises are those with fewer than 100.)

Table 3-3: Job Turnover in the Retail Trade Industry, 1995-96

	Small & Medium Businesses	Large Businesses
Employment Generation	87,765	35,011
Employment Destruction	71,872	26,170
Net Employment Change	15,893	8,841
Job Turnover	159,637	61,181
Churnover Factor	10.0	6.9

Source: DEWRSB (1998), Table 4.15

61. The "churnover factor" is a measure derived by the ABS. In this case it compares job turnover with the number of jobs created in a particular industry. It is the ratio of job turnover to net employment change. As can be seen from Table 3-3, small and medium sized retail businesses have a very high degree of job turnover relative to the number of new employment positions created. This results in a churnover factor of 10 compared with 6.9 for large retail businesses. These figures thus indicate that jobs in the larger retail businesses are more stable.

62. There were 172,604 retail outlets identified by the 1991-92 ABS Retail and Services Census. Of these, more than 53,000 (or 31 per cent) were in the food retailing sector (see Table 3-4).

63. Between 1985-86 and 1991-92, the number of specialised food retailing locations increased by 3198 while the number of supermarkets and grocery stores declined by 1007. Within specialised food retailing there was particularly strong growth in the number of bread and cake retailers, almost a doubling between 1985-86 and 1991-92.

64. Table 3-4 also shows the extent of Coles Food and Liquor group in 1997-98. This covers Coles supermarkets, as well as the Liquorland stores. Note that these figures are not directly comparable with the 1991-92 data for other retailing.

Table 3-4: Shopfront Retailing in Australia

	Locations	Persons Employed	Turnover ($m)	Floor space ('000 sq m)	Turnover/ Employee ($/person)	Turnover / Floorspace ($/sq m)
1997-98						
CML Food & Liquor	**1,188**	**72,738**	**11,559**	**1,720**	**158,918**	**6,721**
1991-92						
Total Food Retailing	**53,166**	**406,299**	**40,811**	**9,963**	**100,445**	**4,096**
Supermarket and Grocery Stores	9,486	180,826	26,102	5,290	144,348	4,934
Specialised Food Retailing	43,680	225,473	14,709	4,672	65,235	3,148
Fresh meat, fish, poultry	7,349	28,459	2,787	744	97,930	3,746
Fruit and vegetable	3,670	18,189	1,893	630	104,074	3,005
Liquor	1,847	8,593	2,094	397	243,687	5,275
Bread and cake	4,771	30,066	1,174	536	39,047	2,190
Takeaway	20,324	118,212	4,885	1,894	41,324	2,579
Specialised	5,719	21,954	1,876	471	85,451	3,983
Department Stores	459	87,148	9,880	3,962	113,372	2,493
Clothing and Soft Good Retailing	21,688	91,138	8,495	3,499	93,215	2,428
Furniture, Houseware, Appliance Retailing	14,268	75,355	12,012	5,971	159,407	2,012
Recreational Goods	12,913	60,071	6,678	2,224	111,176	3,003
Other Personal & Household Goods	28,164	116,986	9,501	5,186	81,216	1,832
Household Equipment Repair Services	3,238	9,654	522	315	54,094	1,656
Selected Personal Services	38,708	223,431	8,275	5,398	37,035	1,533
Total	**172,604**	**1,070,082**	**96,175**	**36,519**	**89,876**	**2,634**
1985-86						
Total Food Retailing	**50,975**	**341,831**	**35,323**	**8,725**	**103,334**	**4,048**
Supermarket and Grocery Stores	10,493	168,524	22,521	4,809	133,638	4,683
Specialised Food Retailing	40,482	173,307	12,802	3,916	73,866	3,269
Fresh meat, fish, poultry	7,801	26,400	2,795	777	105,887	3,599
Fruit and vegetable	3,819	15,493	1,552	495	100,150	3,138
Liquor	1,378	6,073	1,700	327	279,884	5,197
Bread and cake	2,543	12,408	617	227	49,693	2,716
Takeaway	19,430	92,498	4,494	1,660	48,585	2,707
Specialised	6,499	20,479	1,619	430	79,037	3,763
Department Stores	424	95,872	10,488	3,738	109,399	2,806
Clothing and Soft Good Retailing	21,863	84,153	8,090	2,960	96,140	2,733
Furniture, Houseware, Appliance Retailing	12,439	57,655	9,511	4,173	159,405	2,012
Recreational Goods	11,847	47,789	5,747	1,856	111,168	3,003
Other Personal & Household Goods	21,224	79,474	6,326	3,284	81,215	1,832
Household Equipment Repair Services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Selected Personal Services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**

Source: ABS 8613.0, Table 3, and CML *Annual Review and Financial Report, 1998*
n.a. not available

65. One measure of the degree of competition in an industry is the level of profitability, the simplest measure of which is the profit margin conceived as the ratio of operating profit before tax to total turnover. The retail trade industry had the lowest profit margin (2.6 per

cent) of all industries in Australia in 1995-96 (see Table 3-5 below). According to published ABS data (ABS, 8140.0, Tables 33 and 34), large retail businesses achieved a profit margin of 2.7 per cent in 1994-95 compared with 3.9 per cent for the small and medium sized firms. Both figures were well below the all-industries average.

Table 3-5: Australian Business Profit Margins (%)

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
Agriculture, forestry, fishing	12.6	10.8	15.7	18.7	12.2	14.2
Mining	19.5	14.6	16.6	16.2	16.8	17.8
Manufacturing	6.6	5.1	10.0	8.1	8.2	6.7
Electricity, gas and water	7.4	9.3	10.0	12.9	12.4	13.0
Construction	4.3	3.5	4.8	5.0	5.6	4.5
Wholesale trade	2.4	1.3	2.5	2.7	4.1	3.0
Retail trade	**2.1**	**1.4**	**2.9**	**2.8**	**3.5**	**2.6**
Accommodation, cafes & restaurants	0.9	3.8	3.8	3.7	6.9	6.3
Transport and Storage	1.7	3.2	3.6	7.9	5.8	6.1
Finance and Insurance	18.5	18.1	25.2	28.0	23.0	14.4
Communication services	15.3	14.0	13.3	14.2	14.2	24.7
Property and business services	4.5	3.9	7.1	12.8	13.9	13.8
Private community services	8.5	10.9	11.0	15.9	11.6	9.1
Cultural and recreational services	12.0	9.4	12.1	13.6	10.7	6.5
Personal and Other services	6.9	7.8	9.8	7.4	6.9	7.0
All industries	**7.1**	**6.1**	**8.7**	**9.2**	**9.0**	**8.5**

Source: ABS 8140.0

66. Details of the components of these performance indicators are shown in Table 3-6, divided between large and small and medium-size enterprises.

Table 3-6: Retail Trade Summary of Performance

	1991-92			1994-95		
	Small & Medium Enterprises	Large Businesses	Total	Small & Medium Enterprises	Large Businesses	Total
Total Retail Trade						
Sales of goods and services ($m)	84,389	38,313	122,701	87,146	50,726	137,872
Cost of sales ($m)	71,894	32,495	104,390	73,257	42,735	115,992
Cost:Sales ratio	0.9	0.8	0.9	0.8	0.8	0.8
Gross/trading profit ($m)	12,494	5,817	18,312	13,889	7,991	21,880
Gross profit margin (%)	14.8	15.2	14.9	15.9	15.8	15.9
EBIT ($m)	2,413	1,879	4,292	4,198	1,921	6,119
EBIT margin (%)	2.9	4.9	3.5	4.8	3.8	4.4

Source: ABS 8140.0, Tables 32-34.

67. In 1994-95, gross profit margins in retail trade were similar for businesses of all sizes. However, margins calculated on earnings before interest and tax (EBIT) were lower for large businesses than for small and medium enterprises, whereas in the early 1990s they had been higher.

Table 3-7: Food Retailing Summary of Performance, 1991-92

	Supermarkets & grocery stores	Specialised Food Retailing	Total Food Retailing
Sales of goods and services ($m)	25,280	11,536	36,816
Cost of sales ($m)	19,941	7,083	27,023
Cost:Sales ratio	0.79	0.61	0.73
Gross/trading profit ($m)	5,339	4,453	9,792
Gross profit margin (%)	21.1	38.6	26.6
EBIT ($m)	765	685	1,450
EBIT margin (%)	3.0	5.9	3.9

Source: ABS 8622.0, Table 2.

68. Within the food retailing sector, profit margins had tended to be slightly higher in 1991-92 than the average for the retailing industry. Supermarkets and grocery stores had EBIT margins than specialised food retailers, as can be seen from Table 3-7. Comparable, and more recent, figures for the CML Food and Liquor division are presented in Table 3-8.

Table 3-8: Summary of Coles' Performance

	1991-92	1994-95	1997-98
CML Food and Liquor			
Sales ($m)	6,766	8,153	11,559
EBIT ($m)	204	262	395
EBIT margin (%)	3.0	3.2	3.4

Source: CML Financial Report, 1998, (p. 8).

69. The higher mark-up on goods purchased from the specialised food retailers may have been due to a number of factors, including the costs of operating on a small scale and holding specialised stocks. The figures in Table 3-7 nevertheless suggest one consequence that might follow any artificial shifting of retail trade out of supermarkets and grocery chains into smaller stores unable to take advantage of the large firms' economies of scale and scope - final retail prices might become much higher.

70. Other things being equal, higher retail margins translate into higher prices to consumers. If the gross profit margin for small supermarkets and grocery stores is comparable with that calculated for specialised food retailers (38.6 per cent), it follows that consumers are currently paying higher prices for goods bought from them than from large supermarkets such as Coles. Consequently, if the consumers who currently shop in large supermarket chains were obliged to buy all their food and groceries through small specialist retailers at margins indicated above, they would have to pay over 25 per cent more for the same basket of goods. Even if the small supermarkets had a lower gross profit margin of 30 per cent, consumers would still have spend 11 per cent more for their food and groceries. The precise figures can always be debated, but it is clear that restricting sales through larger retailers would add substantially to the cost of an average shopper's basket of purchases.

71. Reducing the major chains' market shares would probably increase employment in "small" retail trade, but it is not clear that there would be a net increase in jobs in the sector as a whole because the higher prices might cause a drop in total demand and therefore in total employment.

3.2. Extent of grocery market concentration

72. The extent of retail concentration depends crucially on the market definition chosen. As shown in Figure 3-1 above, food and grocery retailing makes up 40 per cent of total retail trade turnover, and is the prime area of concern for this submission. Sales by the Coles Myer Group (encompassing Supermarkets, Department stores and discount and specialty stores) were about 15 per cent of retail trade turnover in 1997-98.

73. The *share of stomach* measure accounts for about 55 per cent of total retail trade turnover (40 per cent from food and grocery retailing and the other 15 per cent from the hospitality and services sector). In 1997-98 total turnover based on the share of stomach definition totalled $74,868 million. It should be noted, however, that the components of turnover from each of the retail outlets included in the share of stomach definition comprised all food and non-food related sales and services. If an exact measure of the components of food bought from each establishment were required, then the non-food aspects of turnover would have to be excluded from the calculations.

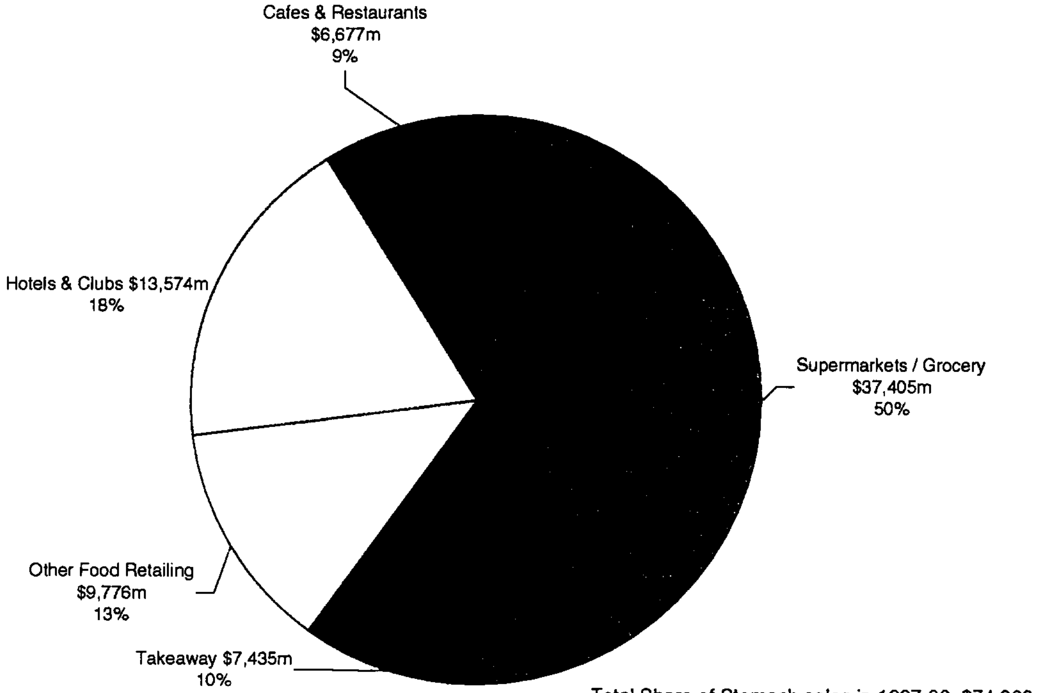
74. The distribution of share of stomach sales across different categories of retailers between 1983-84 and 1997-98 is shown in Table 3-9 below. These financial year shares are comparable with the calendar year figures presented in Table 1-1. Figure 3-3 illustrates the distribution in 1997-98.

Table 3-9: Share of Stomach Measure

	1983-84	1987-88	1991-92	1994-95	1997-98
Supermarkets / Grocery	47%	46%	48%	49%	50%
Takeaway	9%	10%	10%	10%	10%
Other Food Retailing	13%	13%	12%	12%	13%
Hotels & Clubs	24%	23%	19%	19%	18%
Cafes & Restaurants	7%	8%	9%	10%	9%

Source: ABS 8501.0, Table 3.

Figure 3-3: Distribution of Share of Stomach Sales, 1997-98



Source: ABS 8501.0, Table 3

75. Together, all supermarket and grocery stores account for about half of the share of stomach retail sales. Since the mid-1980s there has been a slight move away from food and liquor bought in hotels and clubs, and a slight increase in the share of food and liquor bought from supermarkets and grocery stores, and from cafes and restaurants.

76. As mentioned above, the food and grocery component of the retail trade industry is a subset of the share of stomach measure, and was worth around $55 billion in 1997-98 (ABS, 8501.0, Table 1). It includes total sales from supermarkets and grocery stores, takeaway outlets and other specialised food retailers, but excludes sales from clubs, pubs & taverns, and cafes & restaurants. Within the food and grocery component of the retail trade industry, there is a large number of sub-categories of food (and non-food) items.

77. Coles Myer supermarkets' share (including takeaway outlets) is about 20 per cent of this market, and Coles Myer supermarkets, Woolworths supermarkets and Franklins supermarkets together account for 61 per cent.

78. Another distinction of interest to this inquiry is the split between fresh foods and packaged or dry groceries. The market research group AC Nielsen collects data on dry packaged branded groceries in its Brandscan[5]. surveys (AC Nielsen, 1998). The dry packaged groceries market definition is the narrowest of the market concentration measures used. It is comprised of food and grocery items within the food and grocery retailing sector but **excludes** fresh foods and takeaway foods. Dry packaged groceries account for 62 per cent of the total food and grocery retail trade in Australia. State-by-State market shares of the major supermarket retailers for the year to September 1998 are shown in Table 3-10

[5] Brandscan excludes fresh food, specialty food retailers and many independents. AC Nielsen's research is undertaken in order to track sales and monitor market shares for major brand items, and the shares of their sales across the major retail chains.

below. Coles, Woolworths and Franklins supermarkets account for 80 per cent of the Australian dry packaged goods market.

Table 3-10: Market share of Packaged Dry Groceries Sales, September 1998

	Coles / Bi-Lo	Woolworths	Franklins	Other
NSW/ACT	23.4	36.4	24.2	16.0
VIC	33.8	36.6	8.7	20.9
QLD	31.4	38.6	16.4	13.6
WA	33.4	27.1	n.a.	39.5
SA	38.0	29.9	7.0	25.1
TAS	26.9	73.1	n.a.	0.0
All Australia	**30.3**	**35.9**	**14.2**	**19.6**

Source: AC Nielsen, Retail World, December 14, 1998

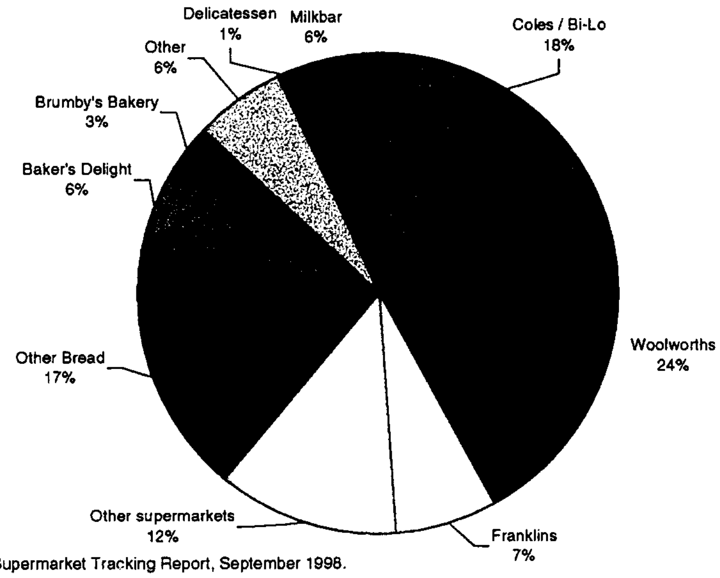
Notes:

1. In Victoria, Woolworths trades as Safeway
2. Purity/Vos is the retailing arm of Woolworths in Tasmania
3. WA's almalgamated independents are serviced by one distributor

79. As with all the definitions discussed, there is some degree of overlap between the definitions and there are some grey areas concerning what is included in each definition. For example, the ABS definition of total food and grocery retailing does not include other retailing items such as personal healthcare products like cosmetics and toiletry retailing, which many supermarkets provide. **The market share of the top 3 retailers in the packaged goods category is therefore likely to be overstated.**

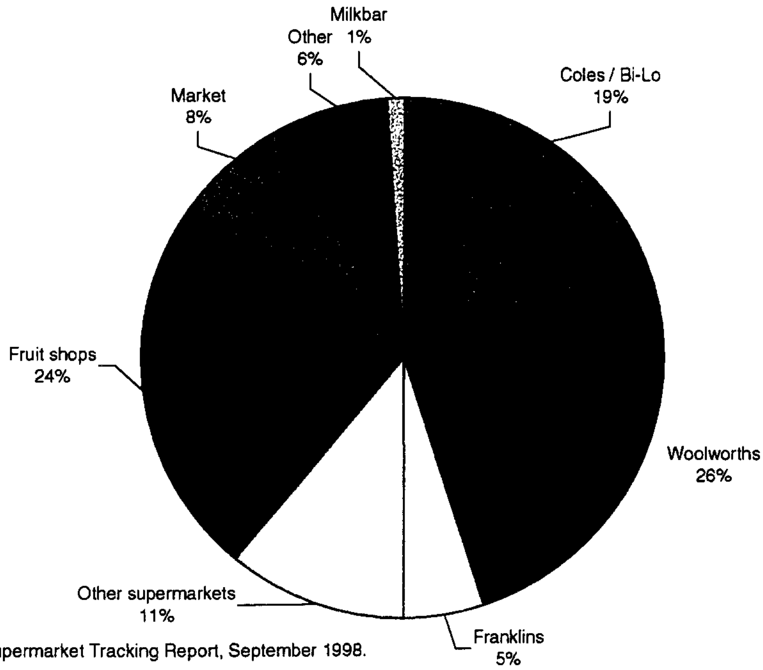
80. Supermarkets compete with a wide variety of other specialty retailers in individual product markets, including petrol stations, newsagents, butchers, milkbars and home delivery vendors. The market shares discussed above are aggregates; it is worth noting the major supermarkets shares of sales in individual categories. Market shares for bakery products, fresh produce, delicatessen and meat are available from Roy Morgan (1998), and are presented in the following Figures. The major supermarkets (Coles, Woolworths and Franklins) together account for between 50 and 60 per cent of sales, roughly in proportion to their shares of food and grocery retailing.

Figure 3-4: Distribution of Bakery Sales, Year to September 1998



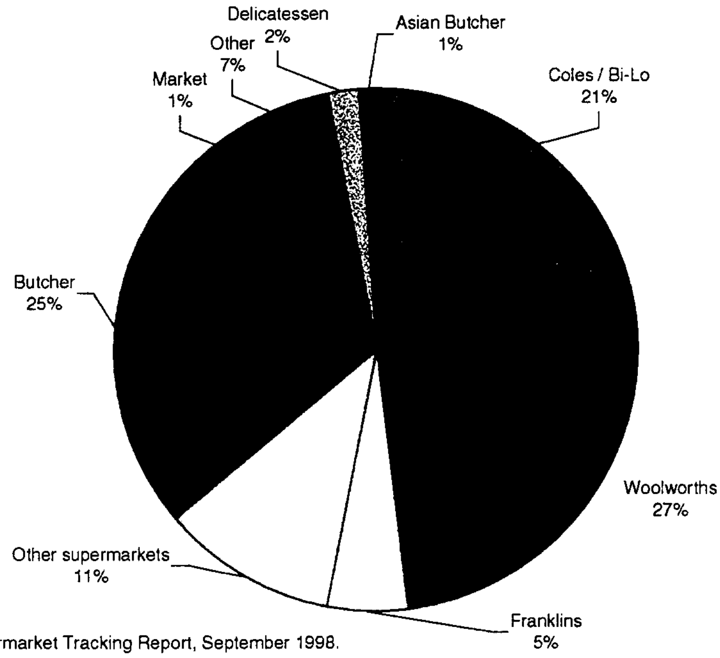
Source: Roy Morgan Supermarket Tracking Report, September 1998.

Figure 3-5: Distribution of Fresh Fruit and Vegetables Sales, Year to September 1998



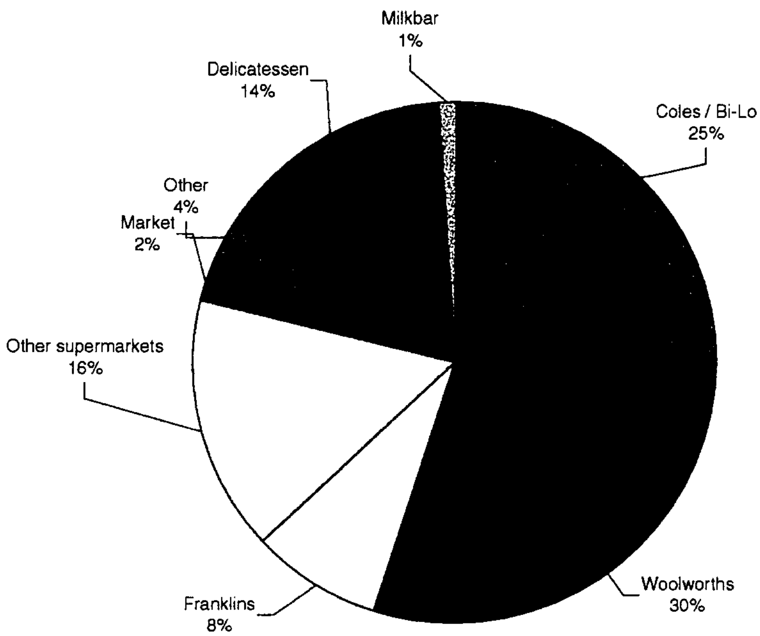
Source: Roy Morgan Supermarket Tracking Report, September 1998.

Figure 3-6: Distribution of Fresh Meat Sales, Year to September 1998



Source: Roy Morgan Supermarket Tracking Report, September 1998.

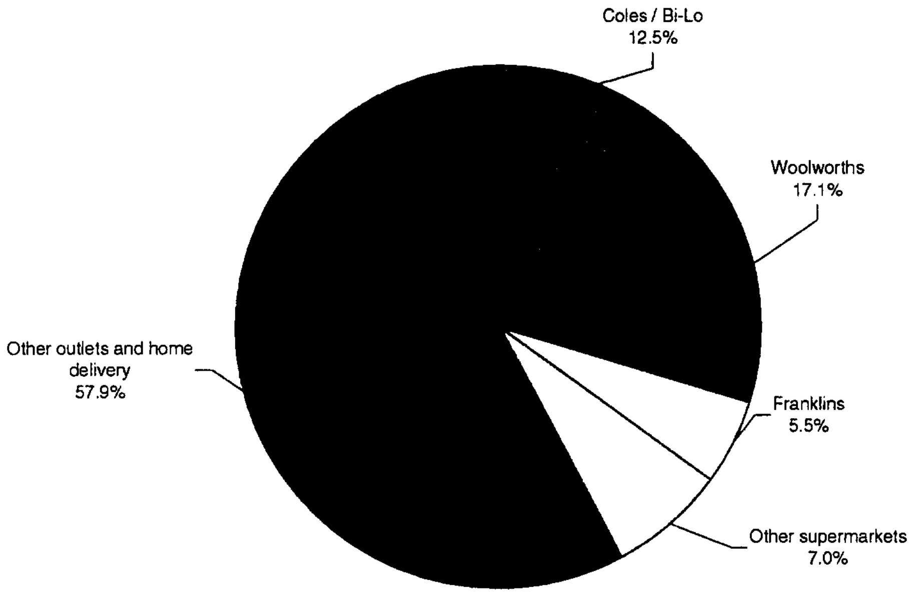
Figure 3-7: Distribution of Delicatessen Sales, Year to September 1998



Source: Roy Morgan Supermarket Tracking Report, September 1998.

81. Market shares for milk are also available from the Australian Dairy Corporation, shown in Figure 3-8. Here the effect of the variety and number of alternative outlets and distributors is particularly marked. The major supermarkets account for only 35 per cent of total milk sales. Coles supermarkets (including Bi-Lo) account for only 12.5 per cent of sales. Most of the total is sold through other outlets and home delivery.

Figure 3-8: Distribution of Milk Sales, Year to September 1998



Source: Australian Dairy Corporation, 1998.

82. Note that the increase in concentration is a global phenomenon, and that the same factors have created the effect in other countries as well as in Australia. The British Office of Fair Trading (OFT, 1997, Section 1.2) discusses the degree and sources of concentration in British retailing, and attributes the increase to:

- Increased use of centralised warehousing and distribution; and
- Increased use of information technology (both by retailers and as an alternative means of distribution for producers).

83. These factors have also played an important part in allowing the major retailers in Australia to reduce their costs and gain market share.

3.3. Freedom of entry and exit

84. As discussed in Section 2.2 above, the efficiency of concentrated markets will depend, inter-alia, on the ability of potential competitors to enter at low cost, including the expected costs of exit. Retailing has relatively low barriers to entry and firms are free to enter and leave at lower cost than in many other industries. This, together with the diversity of sources of wholesale supply, suggests that retailing is in reality likely to be more competitive than other industries with comparable levels of concentration.

85. Note that many of the sunk costs of entry and exit are, proportionally, substantially smaller for a large chain of stores, or for stores in a franchise, than for small retailers, since many establishment expenses (store design, advertising, staffing, purchasing, stock control systems) will already have been incurred on behalf of other stores in the chain. Even when the total costs are apportioned across locations, the share borne by each store will be low compared with costs for an independent retailer attempting to obtain the same services unless they are provided by a wholesaler. A retail chain can therefore enter a market more cheaply than an independent retailer. This implies that more competition is likely to occur between larger chain retailers than between smaller independent retailers.

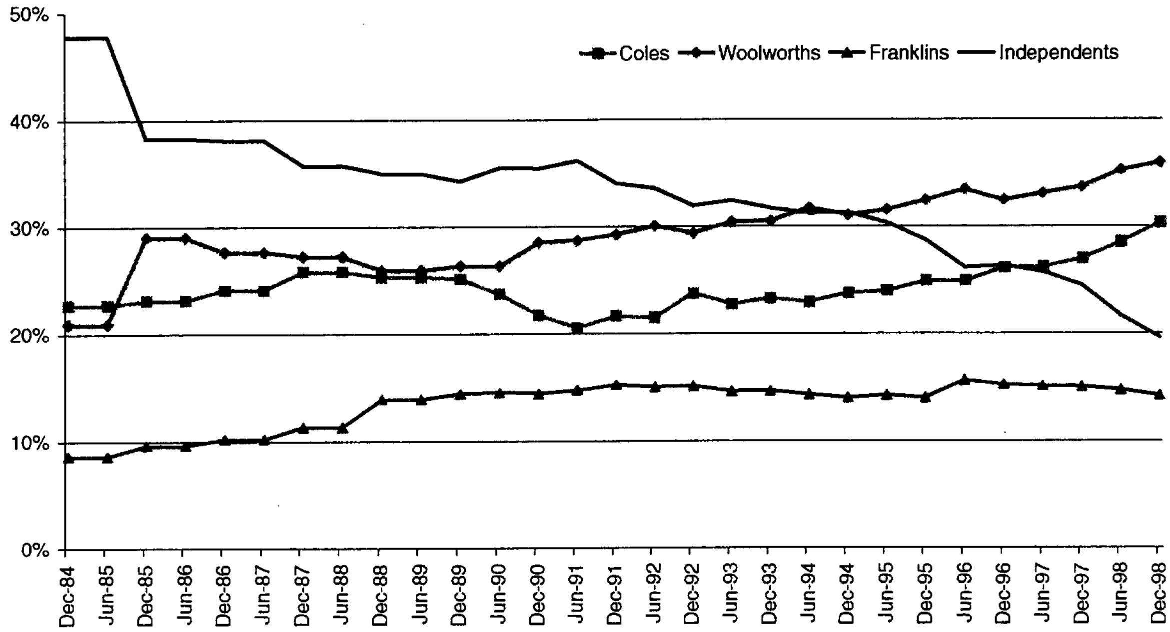
86. The factors that reduce the costs of entry and exit for large retail chains also generate economies of scale, in terms of both store numbers and size. This however creates an offsetting impediment to entry - market niches are fewer and harder to establish. For instance, although a regional centre may have sufficient local demand easily to sustain two large supermarkets, adding a third of comparable size might be unprofitable, yet there could still be scope for a number of smaller, more specialised stores. Nevertheless, if either of the two supposed large incumbents attempted to raise its margins it would either lose market share to existing competitors (large and small) or, if all retailers attempted to sustain the higher prices, this would make entry attractive for a third large player. Alternatively, if one of the large stores consistently failed to minimise its costs or adequately foresee customer demands, it would lose customers to its competitors and create an opportunity for a third operator to take it over or squeeze it out of the market entirely.

87. One consequence of all this is the claim commonly made that no one can provide effective competition to the major retailers - that their market shares are "too big" to be challenged. Theory and experience suggest that this is false. As discussed in Section 2.2, size is not an impediment to competitors if a market is relatively open. While it is admittedly unlikely that any of the major retailers would cede a substantial part of its market share without responding energetically, successful new entry into Australian retailing on a large scale is still possible.

For example, the American toy retailer Toys-R-Us has established itself in the Australian toy, baby ware and leisure goods markets in competition with the existing specialised small retailers and major department and discount stores. Although the larger Australian retailers had substantial departments dedicated to toy sales, there were no large-scale specialised toy stores or chains, and toys were viewed as carrying relatively high margins. Toys-R-Us entered the market with large supermarket-style stores and aggressive pricing, backed by its world-wide buying power and distribution network. The Coles Myer Group attempted to respond in kind to this competition through the establishment in August 1993 of its World 4 Kids toy and leisure superstores. Despite expending considerable resources to combat the new entrant, World 4 Kids was unable to fend-off Toys-R-Us in this store format.

88. Similarly, the shares of retail markets held by the major retail groups have varied substantially, both historically and in recent times. After a period in the 1980s and early 1990s, during which Woolworths supermarkets' share of fresh food sales overtook Coles' market share. Coles has begun to regain a larger share of this particular market. This battle for market share, together with the rise of the Franklins group and the trend decline in the market shares of independents, is illustrated in Figure 3-9 below.

Figure 3-9: Branded Dry Packaged Goods Market Shares, 1984 to 1998



Sources:AC Nielsen, *Retail World Celebrating 50 years*, Vol 50 No 18 Sept 15 - 1997, and AC Nielsen (1998).

89. Possessing large market share is no guarantee of high returns and many of the major retailers (Myer Grace Bros and David Jones, for example) have been through periods in which declining sales and rising costs have reduced their profitability. **In most cases the large retail chains have responded to ailing fortunes by addressing costs and reviewing their customer focus, and have been able to restore their returns, if not always their market share.** There have also been examples of retail chains that have grown strongly in the last decade, carving a niche for themselves by providing particular types and qualities of products (Harvey Norman in furnishings, electrical goods and, especially, home computer hardware and software; Harris Scarfe in general retailing; and Bakers Delight, Cheesecake Shop, Lenard's and Deli France in specialised fresh foods).

90. Some measure of the ease of entry and exit into the Australian retailing industry compared with other industries is available from ABS business surveys. Table 3-11 shows the rates of entry to and exit from various industry groups averaged over 1994-95 and 1995-96, together with the estimated number of businesses in each group at the end of that period. The exit rate is divided between cessations and changes in ownership. Changes in ownership give an indication of the ease of entry and exit in management/ownership of firms in the industry, whereas the rate of cessations needs to be considered in the context of the net rate of growth in the number of firms in each industry.

Table 3-11: Average Rate of Business Exit and Entry in 1994-95 and 1995-96

	Exit Rate			Entry Rate		
	Changes in ownership	Cessations	Total	Including changes in ownership	Excluding changes in ownership	Total Businesses
Mining	0.9%	3.0%	3.9%	13.9%	13.0%	1,000
Manufacturing	1.8%	4.6%	6.4%	7.6%	5.8%	44,200
Construction	0.0%	5.4%	5.4%	19.8%	19.8%	60,050
Wholesale trade	1.6%	4.0%	5.6%	11.3%	9.7%	41,750
Total retail trade	***4.4%***	***5.6%***	***9.9%***	***18.2%***	***13.9%***	***88,800***
Accommodation, Cafes & Restaurants	1.8%	5.6%	7.4%	13.3%	11.5%	24,450
Transport and Storage	1.5%	4.2%	5.7%	15.7%	14.2%	22,500
Property and Business services	0.7%	7.2%	8.0%	19.9%	19.1%	91,300
Other Industries	0.9%	8.2%	9.1%	17.5%	16.6%	95,600
Total	**1.6%**	**5.9%**	**7.6%**	**16.5%**	**14.8%**	**469,650**

Sources: ABS Occasional Paper 8144.0, Table 2; and ABS 1321.0, Tables 2.3 and 2.4.
Notes:
1. The number of exits derived using above figures will differ to those published by the ABS slightly. This is due to sampling errors and differences in the two ABS surveys used.
2. The number of businesses excludes non-employing firms, the finance and insurance industry, agriculture, forestry and fishing, and government administration and defence.
3. All calculations are based on averages over 1994-95 and 1995-96, as in ABS 8144.0.

91. The retail industry had the highest annual average rate of business exits (9.9 per cent) of all industries. Note, however, that this is due almost entirely to a very high rate of change of ownership. While the rate of cessations in retail trade is similar to that in other industries, the rate of change in the ownership of businesses is more than twice the all-industry average and the rate of any other industry. Including changes in ownership, entry rates into the retailing industry are slightly above average, but they are slightly below average when changes in ownership are excluded. Barriers to entry in the retailing industry are thus not distinctly different from those in other industries.

92. Table 3-12 details the total turnover of businesses within each industry group. Turnover is the sum of the exit and entry rates, and is presented both including and excluding the rates of change of ownership of businesses. Excluding changes in ownership, the turnover of businesses in the retail industry is just below the total average turnover of businesses across all industries. However, retailing has the highest turnover rate once the relatively high rate of changes in business ownership within retailing is included.

Table 3-12: Average Turnover and Churnover of Businesses in 1994-95 and 1995-96

	Includes Ownership Changes		Excludes Ownership Changes	
	Turnover of Businesses	Churnover of Business	Turnover of Businesses	Churnover of Business
Mining	17.8%	1.8	16.0%	1.6
Manufacturing	14.0%	11.3	10.4%	8.4
Construction	25.2%	1.7	25.2%	1.7
Wholesale trade	16.9%	2.9	13.7%	2.4
Retail trade	***28.1%***	***3.4***	***19.5%***	***2.3***
Accommodation, Cafes & Restaurants	20.7%	3.5	17.1%	2.9
Transport and Storage	21.4%	2.1	18.4%	1.8
Property and Business services	27.9%	2.3	26.3%	2.2
Other Industries	26.6%	3.2	24.8%	3.0
Total	24.1%	2.7	20.7%	2.3

Source: ABS 1321.0, Tables 2.3 and 2.4; ABS Occasional Paper 8144.0, Table 2.
Notes:
1. Turnover = Total entrants plus exiting businesses.
2. Churnover = New entrants plus those exiting / Net new businesses.
3. All calculations are based on averages in 1994-95 and 1995-96, as done by the ABS.

93. Churnover measures the turnover of businesses within an industry relative to the net increase in businesses in that industry. Thus a higher churnover factor indicates a high level of turnover in businesses compared with the net increase in businesses. Excluding changes in ownership, the retailing industry has a churnover factor of 2.3 which is the same as the all industries average. Including the changes in ownership control within each industry, the retailing industry churnover factor is slightly higher than average.

94. Another significant statistic in analysing the retail trade is the number of retail establishments relative to the population. This removes the effect of the growing population. According to the ABS Retail Census, this ratio was around 10 shops for every 1000 people in all States in 1992. The patterns of change since the end of the Second World War between States and nationally is remarkably similar. Analysis by Professor Geoffrey Kiel of the University of Queensland (1996) demonstrates that, from the late 1940s up until 1980, the number of retailers per head of population declined from around 15 per thousand to around 10 per thousand (See also Table 5-1 below). However, this number has stabilised since 1980 despite significant extensions to retail trading hours. According to Professor Kiel this indicates:

> *A change in the nature of retailing was occurring. The 1950s and 60s were the era of the establishment and growth of supermarkets, relacing the traditional small grocery shops...indeed, the whole patten of shopping changed with the widespread acquisition among households of motor vehicles and refrigerators.*

95. Data relating to the number of retailers per head of population, combined with entry and exits to and from the retail sector, demonstrate that barriers to the entry of firms into the retailing *industry* are no greater than for other Australian industries. Changes in ownership control are actually slightly above average, suggesting lower barriers to entry for control of retail firms.

3.4. Countervailing power

96. The global tendency towards concentration of retail supply has also been matched by increased concentration of suppliers of major brands and product categories, and the growth of wholesale warehouse and distribution companies. This growth can be attributed to the same influences which produce increased economies of scale from production to retailing. The effect is increased concentration at different points in the chain. In consequence the potential market power associated with concentration at one level may be matched by the countervailing power of a large trading partner at another level. This means retailers have a role to play as consumers' representatives to producers. As noted by the British Office of Fair Trading (OFT, 1997, Section 2.1):

> *The fact that consumers' purchases tend to be* ***small*** *means that retailers play an important role in preventing the exploitation of consumers by manufacturers: no single consumer would have any bargaining power against powerful manufacturers, whereas retailers can bargain strongly on their behalf.* (emphasis in the original)

97. Larger retailers' contact with consumers and their preferences means they are also well placed to assist their suppliers, large and small, to develop or specialise in products that will appeal to consumers. Small independent retailers cannot directly offer producers the same information or expertise on aggregate.

98. Retailers also have to deal with concentrated supply of many of their essential factors, other than merchandise. While competition reforms have mitigated their power, the telecommunications, electricity, gas and water industries are all still dominated by a small number of firms. Australia also has a highly concentrated market for retail floorspace. While there is around 40 million square metres of retail floor space in Australia, the ongoing shift to regional shopping centres away from central business districts and suburban 'strip' centres, means that national retail chains have relatively few options when considering locations for their stores. For example, Melbourne's population hosts only eight regional centres other than the CBD. While many smaller retail stores are owner occupied, ownership of the major Australian shopping complexes, of which there are some 78 in Australia, is relatively concentrated. Table 3-13 below shows the ownership and market shares of the major Australian shopping centres. Three groups control 60 per cent of these regional shopping centres, which account for a similar share of both their total gross lettable areas and retail turnover. In total, these 78 centres account for about 14 per cent of Australian retail sales.

Table 3-13: 1998 Ownership of Australian Retail Space

Owner (or controlled by)[1]	Regional Centres[3]		Gross Lettable Area (Retail)		Moving Average Retail Turnover	
	Number	% Total	sq m	share %	$m[4]	share %
Westfield[2]	27	34.6%	1,520,790	35.9%	6,864	35.6%
Lend Lease	11	14.1%	580,953	13.7%	2,846	14.8%
AMP	9	11.5%	561,790	13.2%	2,593	13.5%
Total Top 3	**47**	**60.3%**	**2,663,533**	**62.8%**		**63.9%**
Gandel	5	6.4%	286,527	6.8%	1,372	7.1%
QIC	5	6.4%	261,335	6.2%	1,251	6.5%
Total Top 5	**57**	**73.1%**	**3,211,395**	**75.7%**		**77.5%**
Others	21	26.9%	1,030,687	24.3%	4,341	22.5%
Total All Regional Centres	**78**	**100.0%**	**4,242,082**	**100.0%**	**19,267**	**100.0%**

Notes:

1. Some centres are jointly owned. In some centres the owner is passive, allowing the manager to control the centre.
2. Includes three centres jointly owned by Westfield & AMP
3. Generally as defined by the Property Council of Australia
4. Shopping Centre News 1999

99. Some indication of the level of concentration of ownership of major product supplies can be obtained from the A C Nielsen retail sales data. Table 3-14 shows the 20 companies with the largest sales to Coles supermarkets in 1998, together with those companies' shares of their respective product markets in Australia. The figures give a good indication of the relative importance of the major producers. These mainly multinational brand owners include: Unilever, Coca-Cola, Kimberley-Clark and Nestlé.

Table 3-14: Coles' Top 20 Branded Dry Packaged Goods Suppliers

	Annual retail sales ($m)	Share of total sales (%)	Share of product market (%)	Primary Business
Goodman Fielder[1]	248.9	2.62%	20.4%	Cereal
Philip Morris	222.5	2.34%	38.4%	Cigarettes
Nestlé	213.1	2.24%	63.0%	Coffee
Coca-Cola	186.7	1.96%	62.9%	Soft drink
Rothmans of Pall Mall	163.2	1.72%	34.7%	Cigarettes
WD & HO Wills	152.9	1.61%	26.9%	Cigarettes
National Foods	139.6	1.47%	36.1%	Chilled desserts
Kimberley-Clark	138.3	1.45%	72.6%	Nappies
Unilever Group	130.2	1.37%	36.4%	Canned fish
Uncle Ben's	119.0	1.25%	55.8%	Pet food
Simplot	116.9	1.23%	34.3%	Frozen foods
Carter Holt Harvey	111.3	1.17%	41.4%	Toilet paper / towels
Colgate-Palmolive	110.9	1.17%	44.9%	Dental health
George Weston (inc. Tip Top)	109.1	1.15%	32.0%	Bread
Kelloggs	105.7	1.11%	53.7%	Cereal
Cadbury Schweppes	103.1	1.08%	35.4%	Confectionery
Kraft	101.9	1.07%	20.5%	Cheese
Dairy Farmers	91.5	0.96%	12.2%	Cheese
H J Heinz	56.7	0.60%	59.1%	Convenience meals
Pepsi	31.9	0.33%	10.7%	Soft drink
Other	6858.3	72.10%		
Total supermarket	9511.7	100.00%		

Source: AC Nielsen
1. Includes Uncle Toby's, Meadow Lea, Buttercup.

100. Each set of brands and products represents a significant share of the product market and reflects the power their market shares give them in negotiating with retailers. Because a large part of the attraction of supermarkets for customers lies in the variety of goods on offer, no store can afford not to stock all popular brands (by definition, those with large market shares). Without suggesting that these producers actually do exert the power implicit in their market shares, it is clear that an industry lacking the countervailing power of the major retail and wholesale buyers, and comprised solely of small independent retailers, would be at a significant commercial disadvantage. Larger chains are better able to offer consistent presentation and geographic coverage which the large corporations prefer for their products.

3.5. Historical influences

101. In a recent report, *Aspects of Structural Change in Australia*, the Productivity Commission (1998: Box 1.1) summarises some of the factors influencing the structure of the national economy, and lists four market-related sources of economy-wide structural change:

- Technological change;
- Behavioural changes;

- Trade and global specialisation; and
- Resource discovery and depletion.

102. These factors also influence the structure of individual industries, and of them the first two have had the greatest influence over the development of Australian retail trade.

103. As discussed in Part 1 of the submission the history of retailing is a story of continuous change. On the demand side it has been influenced by rising incomes, the changing composition of the population and the rising proportion of women in the work force. People are better informed and more demanding in terms of choice and quality of products. Social change and greater involvement of women in the work force has also influenced when people wish to shop and the time they are prepared to devote to shopping. Given improvements in transportation and widespread ownership of cars, consumers have much greater flexibility in terms of where they can shop.

104. On the supply side, refrigeration and more recently computer technology have influenced the industry markedly. There have also been ongoing improvements in management. The number of items on offer to the consumer in the largest stores has grown from about 400 soon after the Second World War to 40,000 or more today. There has been a marked growth in the number of large stores but they can still be located alongside smaller stores that cater for more specialist demands in terms of goods (and services) in niche markets. Retailing remains a very competitive industry characterised by low margins and ease of entry and exit. Experience in the US and elsewhere has underlined the advantages of retailers developing close relations with suppliers in terms of generating cost savings and communicating changing consumer demands to manufacturers. Centralisation of buying and developing closer relations with suppliers has been a feature of Australian retailing in the past decade or so.

105. In terms of statistical measures, Australian retailing is relatively concentrated but is not out of line with other relevant countries (Canada, for example). Moreover, the concentration of Australian retailing is not *a priori* evidence of "unfair competition". The growth and oscillating fortunes of the major retail chains is evidence of their precarious grip on market share, and the effectiveness of competitors, large and small, to ensure that goods and services are delivered to consumers efficiently, and without excessive returns. Moreover, recent history suggests that there is still scope for quite small players to expand to become significant retailers within a relatively short time.

106. This suggests that competition, although not the product of the interaction of a large number of identical small suppliers, is still effective in Australian retail markets. The potential for small competitors to enter the market and grow also suggests that competition is fair, in that the major retailers are unable to use their market power to exclude competitors or restrict their activities. Entry to retail markets is open and relatively cheap compared with many other industries. Success in retailing still derives from sheer ability at predicting and meeting the demands of consumers, rather than from stifling competition.