

National Association of Retail Grocers of Australia

The economic contribution of small to medium-sized grocery retailers to the Australian economy, with a particular focus on Western Australia



June 2007

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Acronyms

Acronym	Meaning
ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
ASX	Australian Stock Exchange
AWE	Average Weekly Earnings
BRW	<i>Business Review Weekly</i>
CPI	Consumer Price Index
FTE	Full Time Equivalent
FUM	Funds Under Management
GDP	Gross Domestic Product
GSP	Gross State Product
GVA	Gross Value Added
IGA	Independent Grocers of Australia
IGA>D	IGA-Distribution
IGP	Industry Gross Product
IVA	Industry Value-Added
MGR	Major grocery retailers (eg Woolworths, Coles)
NARGA	National Association for Retail Grocers of Australia
NSW	New South Wales
NT	Northern Territory
PwC	PricewaterhouseCoopers
QLD	Queensland
SA	South Australia
SMEs	Small to medium-sized enterprises (also referred to as independent retailers)
SOI	Southern Oscillation Index
TAS	Tasmania
TPA	<i>Trade Practices Act 1974</i>
UK	United Kingdom
USA	United States of America
VIC	Victoria
WA	Western Australia

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Executive Summary

Report Objective

The National Association for Retail Grocers of Australia (NARGA) has commissioned PricewaterhouseCoopers (PwC) to assess the economic contribution of small and medium-sized businesses (SMEs) in the supermarket and grocery retail industry to the Australian economy with a specific focus on Western Australia (WA). The focus on the state of WA is due to SMEs having a 32% share of grocery turnover in this state compared to the national average SME market share of only 20%.

This Executive Summary contains a range of statistics. The source of each statistic is provided within the footnotes in the core of the report.

Importance of small and medium-sized businesses

SMEs across all sectors have played a substantial role in contributing towards wealth generation in the Australian economy. SMEs enhance competition and consumer choice. It is estimated that the total value of family-owned businesses in 2006 was A\$4.3 trillion, which represents a greater value than the total of the ASX market capitalisation of all listed companies plus the total value of all managed funds in Australia. Household expenditure, which represents 60% of GDP, and retail trade, which represents 23% of GDP, also play key roles in facilitating sustainable economic growth.

Other key findings on the economic impact and contribution of grocery SMEs to the Australian and Western Australian economies are summarised below.

Sales and retail contribution

Retailing represents one of the most significant contributors to economic growth. It constitutes the culmination of all processes along the supply chain to the final customer. Grocery stores are also often the anchor or hub of retail centres, drawing customers to shopping areas and sustaining local communities.

Australia

- The single largest component of expenditure, food and non-alcoholic beverages, accounts for approximately 17.1% of total household expenditure
- Supermarket and grocery sector is the largest contributor to retail turnover (accounting for 29%, with this consistently growing over the past two decades)
- Retail trade plays a vital role in supporting other Australian industries, including:
 - Specialised industries such as road transport, commercial refrigeration and storage
 - Food and beverage manufacturing (which represents 21% of the total Australian manufacturing industry)
 - Food wholesaling (which represents 16% total Australian wholesale trade).

Executive Summary

- Gross Value Added (GVA) of retail trade, food, beverage and alcohol manufacturing, road transport, and transport services and storage was approximately equal to over 11% of GDP in financial year 2006, indicating the strong economic contribution that retailing and its support services make to the national economy
- Revenues generated in the supermarket and grocery sector over the year to January 2007 were \$63 billion. If sales of groceries outside traditional supermarkets are included (eg sales direct from wholesalers to the hospitality sector), the total grocery revenues are approximately \$74 billion, of which SMEs account for approximately \$15 billion (as seen below)

Characteristics associated with market participants in the grocery industry

Market Participants	% Turnover	Stores	Turnover	FTEs	FTEs per store
Top 2 – Woolworths & Coles	78-79%	1,493 (24%)	\$59 billion	108,833 (43%)	65
Top 4 – Woolworths, Coles, ALDI & Pick 'n Pay (Franklins)	80%	1,683 (27%)			
Independent grocery banner groups – IGA, FoodWorks, Ritchies	18.9%	2,140 (35%)	\$15 billion	144,267 (57%)	32
Other independent grocery retailers	1.1%	3,291 (53%)			
TOTAL	100%	6,183	\$74 billion	253,100	

- Around 6,183 supermarket and grocery retailers operate across Australia. Close to 73% of these are independent grocery retailers who hold close to 20% market share (based on turnover)
- IGA is the largest banner group of independent retailers. However, IGA is only one of several large banner groups which include FoodWorks and Ritchies. Independent retailers which are part of these banner groups account for around 18.9% of total market share with 2,140 stores (or 35% of total store numbers) around Australia
- Sales increased by 6.3% for IGA stores and by 6.0% for Foodworks stores in financial year 2006. This compares favourably with Australian retail sales growth of 4.3%
- Industry Value-Added (IVA) for the supermarket industry in 2006/07 is estimated at \$18.6 billion (or close to 27% of total industry revenues). SMEs account for approximately 56% of total retail IVA

Western Australia

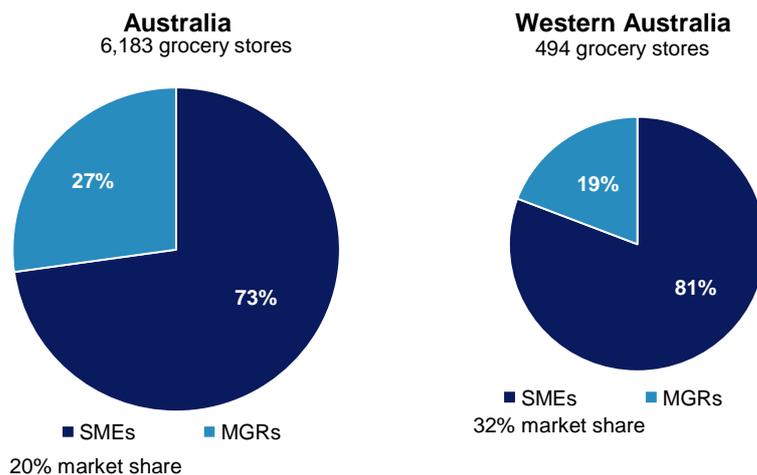
- WA's Gross State Product (GSP) reached approximately \$108 billion as of June 2006, approximately 12% of Australia's GDP, with only 10% of the population
- The WA retail market has significantly outperformed the national retail market over a 10 year period and food retailing has kept pace with growth in retail turnover. The higher rate of retail market growth in WA is due to factors including strong commodity prices coupled with population and wages growth being generally above the national averages

Retail turnover nationwide and in Western Australia



- WA retail trade accounts for 11% of total retail turnover in Australia and retail employment accounts for 10% of nationwide retail trade employment, approximately equal to their contribution to the population
- Retail trade in WA has consistently grown as a proportion of nationwide retail trade, growing from approximately 9.8% at the end of 2003, to approximately 10.9% of total Australian retail trade as at January 2007
- Total retail turnover represents 20% of WA's GSP in 2006. Across Australia retail turnover equates to 23% of national GDP
- The supermarket and grocery trade for the year to January 2007 accounted for approximately \$6.8 billion in turnover, consistent with the national average of approximately 29% of total retail trade
- WA has the highest proportion of independent grocery stores when compared with all other Australian States and Territories
- WA grocery SMEs have 32% of share of total grocery turnover and 81% of stores. This compares to the national average for SMEs which have 20% of total grocery turnover and 73% of total stores

SMEs as a proportion of total grocery retailer numbers in Australia and WA



Employment generation

The retail and food sector is the largest employer in the Australian economy. Its proportion of the total labour force has risen from 4.7% in 1985 to almost 5.5% in 2006.

Australia

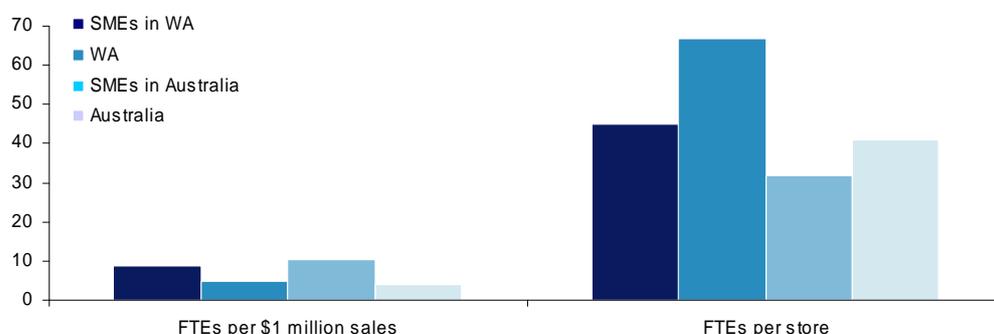
- Almost 1.5 million people are employed in retail trade, translating into 1.15 million FTEs
- The supermarket and grocery industry accounts for 26.5% of total retail employment and 3.8% of Australia’s total labour force, with 397,198 employees or 253,100 FTEs
- SMEs play a vital role in the retail industry, accounting for 57% of total supermarket and grocery employment

Supermarket & Grocery Employment	Total Sector			SMEs		
	Australia	WA	WA as % of total	Australia	WA	WA as % of total
FTEs	253,100	33,310	13.0%	144,267	18,133	12.5%
Staff	397,198	43,885	11.0%	226,400	23,859	10.5%
% employed by SMEs	57%	54%				

Western Australia

- WA accounts for around 10% of total retail trade employment – approximately proportional to its contribution to the Australian population
- The supermarket and grocery industry accounts for 28% of total retail employees, slightly higher than the national average. This represents around 43,885 employees and 33,310 FTEs
- SMEs play a vital role in the industry, employing 54% of total supermarket and grocery employment (slightly below the national average), equivalent to 23,859 employees or 18,133 FTEs
- Employee growth rates in WA, and the retail industry in WA in particular, have been consistently higher than national averages since the early 1980s
- SMEs have relatively higher labour intensity (when measured in terms of FTEs per \$1 million in sales) than the average levels for all grocery retailers in WA and across Australia.

Comparison of labour intensity in the grocery retail sector, 2005/06



Concentration of the retail sector

Australia has one of the most concentrated grocery markets internationally. The dominance of the major grocery retailers (MGRs) is clearly established with the market share of the top two MGRs being approximately 78-79%.

Due to the concentrated nature of the supermarket and grocery retailing sector in Australia, MGRs have financial power and growing market power, stemming from their high market share. The MGRs, and to a lesser extent the IGA group, utilise economies of scale and associated lower unit costs, to offer very competitive prices for high volume or headline products bringing benefits to consumers, but there is often less discounting applied to lower volume products. This arguably can moderate headline grocery price inflation but under state the change in grocery costs when it is measured over a large range of grocery products.

It would be expected that lower unit costs should translate into consistently lower prices across a wide range of products for consumers. However, concerns exist that the growing market dominance of the MGRs and the decline in the number of independent grocery stores over the past decades has arguably moderated competition in the grocery industry which has potentially added to food price inflation.

Whilst the *Trade Practices Act 1974* (TPA) prohibits acquisitions which substantially lessen competition within defined markets, the nature of this test means that minor or so called “creeping acquisitions” by MGRs, (ie purchases of existing independently-owned stores or opening of new stores) are not precluded by the TPA. Hence MGR activity in minor acquisitions and new store openings has lifted market share concentration in the grocery sector.

Therefore, SMEs clearly have an important role in promoting and maintaining competition in the supermarket and grocery retail industry and the economic efficiency, consumer choice and quality that are associated with a successful competitive industry.

Economic contribution and wealth creation

Small enterprises alone represented 96.8% of total retail trade businesses in Australia in 1999/2000, demonstrating their strong economic contribution. In addition, small businesses which tend to be independently and locally-owned often play a vital role in generating and retaining wealth in local economies.

The business value of grocery SMEs in WA suggests that each independent retailer has an average value of \$1.615 million. SMEs in WA tend to reinvest most of their earnings within the local and WA economies. MGRs are comparatively less likely to be reinvest at a local community level and they typically distribute over 60% of earnings as dividends to institutional and retail shareholders who are largely on the eastern seaboard of Australia.

The intra-industry flows between retail trade and a diverse range of sectors emphasises the important flow-on effects of the retail trade industry. In 1996/97, the retail trade sector procured supplies from 90 industries (of a total of 106 as defined by the ABS) valued at over \$23.3 billion.

Studies show that although the total wealth contribution of SMEs in the supermarket and grocery industry is smaller than that of MGRs on a national aggregate level, the wealth contribution to local economies by SMEs can be 2-3 times greater at a local level than that of MGRs. This is related to the fact that SMEs source a greater proportion of their goods and services from local producers and local service-providers, and account for a larger proportion of grocery employment than the market share they hold, thereby providing relatively more stimulus to local economies.

Social and community engagement

Beyond the quantitative economic impacts that SMEs provide, they generate significant social and environmental benefits for local communities and states as a whole. For example:

- SMEs contribute to community character, cohesion and well-being with most SME business decisions being made within the community. The typical high street location provides a mechanism for better connecting local communities
- SMEs assist sustainable economic prosperity as locally owned businesses generally reinvest a larger share of revenues or profits back into local and State economy than MGRs. In addition to keeping more of the profits in a locality, they often create opportunities for a variety of other local businesses and service-providers and employ more local people in proportion to their overall revenues than MGRs
- SMEs (in combination with MGRs), particularly in the retail sector, also provide many thousands of entry-level employment opportunities, and contribute to the development of transferable job skills (eg communication skills) and valuable attitudes to work and personal development
- The ability to establish an SME promotes entrepreneurship facilitating the opportunity for all socio-economic groups, particularly lower income groups, to apply economic innovation to create business value
- SMEs enhance competition and consumer choice
- SMEs provide environmental benefits and sustain local environments by helping maintain town centres. The presence of a larger proportion of SMEs on High Street locations which have higher levels access via walking means that many SMEs also make a contribution to reducing traffic congestion, car parking shortfalls and pollution.

Future opportunities

SMEs are important for sustaining competition, enhancing consumer choice and moderating long-term grocery price inflation. The ability of SMEs to provide value-add to consumers often through factors such as convenience, tailored product range, more personalised service and customised store layout for local needs will be critical to their ongoing economic participation and success.

The greater market share of independent grocers in WA (32%) provides higher local employment and statewide economic benefits than if grocery retailing transitioned to the national average where independent grocers have a 20% market share. For example, if the market share of independent grocers in WA fell from 30% to 20% (all else held equal), this could translate into approximately 3,800 fewer jobs in the grocery retailing sector in WA.¹

¹ This figure is calculated on the basis that if SMEs were to lose 10% market share in WA (or one-third of their market share), SME head count would reduce by a similar proportion (or 6,044 FTEs). This loss in employment would be mitigated by an increase in employment by MGRs proportionate to the 10% increase in market share (or 2,168 FTEs). Despite this, a net loss in employment of 3,876 FTEs (6,084 less 2,168) would be likely to result if the market share of independent grocery retailers reduces from approximately 30% to 20%.

Furthermore, a decrease in independent grocery market share would also have detrimental impacts on businesses which support independent grocery retailers (e.g. local accountants, local printers, smaller primary producers and local storage, warehousing and wholesalers). Most of these support services would be likely to be procured interstate or centrally by MGRs. Therefore, the local businesses and employees supported by independent retailers, and the communities in which independent grocery retailers operate who gain significant social and community benefits as a result of the economic participation of SMEs, would be adversely impacted by any reduction in their market share.

While there are risks associated with operating in one of the most concentrated grocery retail markets in the world, the rationalisation of SMEs into banner groups such as IGA and FoodWorks and their alliance with Metcash may offer an opportunity for independent retailers to challenge the MGRs. PwC's 2007 publication of *Retail & Consumer Outlook Australia – Changes in play* highlights that:

“While independent retailers can feel confident that they have a bright future, they still have to plan how they will deal with the tectonic forces generated by Australia’s two grocery retailing giants.”

It is important that policymakers are cognisant of the policy settings pertinent to the retailing industry. This will be critical to ensuring that competition is promoted in the grocery industry and that competitors are not disadvantaged by the extending dominance of MGRs under pressure to deliver increased earnings.

In addition, particularly in the retailing sector, SMEs are disproportionately burdened by compliance imposts and regulatory requirements. Due to the cumulative economic size of SMEs, reductions in “red tape” could be expected to deliver significant productivity and other net benefits to the Australian economy.

It is also important that the significant beneficial economic impact of SMEs is acknowledged and appreciated. Whilst it may be a small component of the total economy and MGRs generate significantly greater volumes of sales, SMEs constitute the majority of grocery stores and make a critical contribution in their own right to servicing customers in more regional and remote areas, as well as providing greater choice for consumers. Independent retailers have an economically valuable role as a balancing competitive force against the MGRs and as enhancers of consumer choice and welfare in the grocery retailing industry.

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1 Introduction

1.1 Context

The retail grocery industry in Australia is a vital component of the national economy. This sector in the economy is currently represented by the National Association of Retail Grocers of Australia (NARGA), a body that promotes the interests and the concerns of independently-owned small and medium-sized businesses (also known as small to medium-sized enterprises or SMEs), most of them grocery retailers.

NARGA is a federation of State-based retailer associations in each Australian State and Territory. These are:

- IGA Retail Network (Independent Grocers of Australia)
- Retail Traders and Shopkeepers Association of New South Wales
- Master Grocers Australia
- Queensland Retail Traders & Shopkeepers Association
- WA Independent Grocers Association
- State Retailers Association of South Australia
- Tasmanian Independent Retailers

NARGA's role is to represent independent retailers' interests across the board. NARGA also ensures that the point of view of independent grocery retailers, who seek a chance to compete freely in the market place, is expressed through submissions to parliamentary and bureaucratic inquiries.

As a result of this representative role, NARGA has demonstrated a keen interest in exploring the economic contribution of SMEs to the Australian economy and Western Australia (WA) in particular which has a higher market share for SMEs in grocery retailing compared to the national average. Reviews of other State economies may be undertaken at a later date.

1.2 Purpose

The purpose of this report is to assess the economic contribution, role and impact of SMEs in the supermarket and grocery retail industry within the Australian economy.

The emphasis of the latter part of the report is the economic contribution of SMEs in WA, where SMEs form the highest proportion of the retail grocery trade of any other Australian State or Territory. The study will analyse each area of interest in the Australian context, with additional detail provided in the WA context.

1.3 Definitions

1.3.1 Grocery retail

The focus of this report will be the supermarket and grocery retailing industry. ACNielsen defines grocery retail as all branded packaged groceries (ie dry goods) excluding housebrands. This report will adopt this definition with a key difference in that housebrands or private labels will be examined as a component of growing importance and relevance in the grocery retail industry.

For the purposes of this report it is assumed that liquor products, fuel and petroleum products, takeaway, restaurant and other food retailing products, are all sold outside the grocery retail sector. However, these retailing components may be referred to throughout the report.



Goods retailed by the supermarket and grocery industry may also be purchased from a range of over 30,000 other stores in a variety of industries, including:

- convenience
- fruit and vegetable
- bread and cake
- automotive fuel
- newspaper, book and stationery
- takeaway food
- fresh meat, fish and poultry
- pharmaceutical, cosmetic and toiletry
- Department stores
- milk vending operators
- other specialised food stores
- Boutique or specialist independent retailers (eg delicatessens, niche food importers, organic specialists, fruit, meat and seafood markets).

Therefore, small independent convenience stores, and other similar corner and general stores selling grocery products are considered to form part of the grocery retailing sector. This is an important condition when considering the number of stores in the industry.

1.3.2 Small to medium-sized enterprises (SMEs)

According to the Australian Bureau of Statistics (ABS), a small business is defined as business employing less than 20 people. The categories of small business include:

- non-employing businesses – sole proprietorships and partnerships without employees
- micro businesses – businesses employing less than 5 people, including non-employing businesses
- other small businesses – businesses employing 5 or more people, but less than 20 people.

Medium-sized businesses refer to businesses employing 20 or more people, but fewer than 200 people.

The focus of this report is both small and medium-sized enterprises in the retail grocery sector, as the majority of independent grocers are categorised either as small or medium-sized enterprises.² SMEs refer to small and medium-sized grocery retailers and this term is interchanged with the term 'independent grocery retailer'. SMEs in the grocery retail sector are generally characterised by independent ownership, and independent control over decision-making and operations by store management.



² It should be noted that most independent grocers are either small businesses towards the large end of the spectrum, or medium-sized businesses towards the smaller end of the spectrum within the definition.

2 National overview of the retail and grocery industries

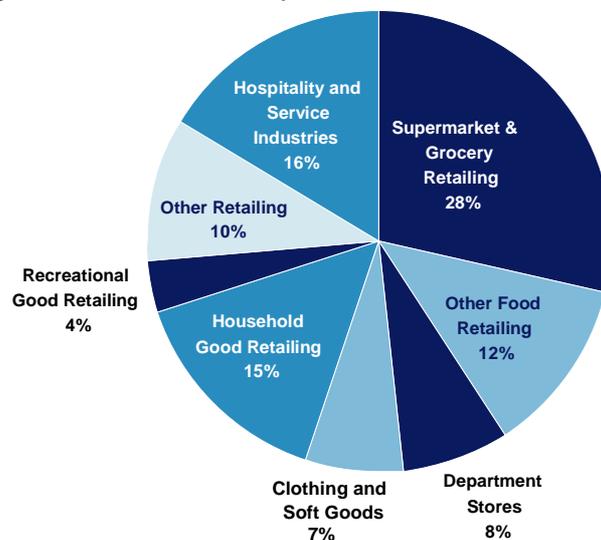
Retailing is where enterprise meets household and community. It is where the value-added of the extraction, processing, manufacturing, wholesaling and distribution chain culminates with sales to the final customer.³ Therefore, the retail grocery industry plays a key role in facilitating sustainable economic growth in Australia.

Household consumption comprises approximately 60% of Australian GDP, valued at close to \$934 billion in 2006.⁴ Retail trade, and grocery expenditure in particular, represent a core feature of this discretionary spending component.

Retail trade alone accounted for approximately 23% of GDP in 2006.⁵ Food and non-alcoholic beverages account for 17.1% of total household goods and services expenditure. This component constituted the single largest category of average weekly household expenditure.⁶

The supermarket and grocery sector is the largest segment of retail turnover in Australia, contributing approximately 28% of total retail expenditure (see Figure 2.1 below). This figure now stands closer to 29%. Total food retailing (including grocery trade) comprises approximately 40% of total retail trade, by far the largest component of expenditure.

Figure 2.1: Breakdown of components of retail turnover, 2006



Source: ABS Cat. 850101

³ Institute for Local Self-Reliance, *The New Rules Project*, available at <http://www.newrules.org/misc/whynewrules.htm>. Accessed 12 April 2007.

⁴ Seasonally adjusted data has been used where available. Australian Bureau of Statistics (ABS), Catalogue (Cat.) 5206006. Calculated according to an Industry Gross Value-Added measure.

⁵ ABS, Cat. 850101 & 526006. Retail trade calculated on the basis of Industry Turnover, GDP calculated according to Gross Value Added to the economy.

⁶ ABS, Cat. 65300 "Australia Data 2003-04rev".

The proportion of retail trade represented by supermarket and grocery expenditure has been consistently growing over the past two decades, as shown in Figure 2.2. This may be due to the increased product range available at supermarkets. For example, the proportion of retail trade contributed by Department stores and newspaper and stationery retailers has shown a sustained decrease over a similar period. This suggests that their products are no longer exclusively available in their stores and supermarket retailers are expanding their product ranges to attract greater sales.

Figure 2.2: Grocery store turnover as a proportion of retail turnover



Source: ABS Cat. 8501019

This greater product choice and cheaper pricing on some core headline products in supermarkets may be an attempt by grocery retailers to increase market share by becoming a “one stop shop” for both basic and more advanced product needs. This in turn may be acting as a means to increase the market share of the grocery industry as a component of retail trade.

In addition, food is one of the largest contributors to growth in the CPI. As demonstrated in Figure 2.3, food prices have consistently grown at a higher rate than the CPI and in the most recent years food price inflation has risen significantly. Therefore, it appears that food price inflation has potentially boosted supermarket and grocery store turnover as a proportion of total retail turnover.

There are also suggestions that the measured level of food price inflation may underestimate the true rise in the cost of grocery goods. That is, the MGRs may be running “loss leaders”, or providing lower prices, on high volume food staples included in the CPI food basket, thereby hiding the rise in prices of other grocery goods which are growing at a greater rate.

Furthermore, over certain periods of sustained drought, as measured by negative values for the Southern Oscillation Index (SOI), there has been rising food inflation.⁷ However, there does not appear to be any consistent pattern or correlation between negative SOI values and food inflation.

⁷ The Southern Oscillation Index (SOI) as measured by the Bureau of Meteorology is calculated from the monthly or seasonal fluctuations in the air pressure difference between Tahiti and Darwin. Sustained negative values of the SOI often indicate El Niño episodes. These negative values are usually accompanied by sustained warming of the central and eastern tropical Pacific Ocean, a decrease in the strength of the Pacific Trade Winds, and a reduction in rainfall over eastern and northern Australia. Therefore, the SOI has a strong correlation with drought conditions.

Figure 2.3: Comparison of food price inflation and total CPI

Source: ABS Cat. 640102

The economic contribution of the supermarket and grocery retail industry is not confined to the revenues and employment generated in supermarket stores alone. Its contribution incorporates the entire value or supply-chain servicing this industry. This is particularly relevant in rural and regional areas where grocery stores play an even greater role in supporting local primary producers and downstream suppliers.

Derived demand for the products of primary producers, manufacturers and wholesalers is heavily dependent on the retail industry. These industries form part of the supply-chain for the retail industry, and benefit from the success and sustained growth of a wide range of diverse supermarket retailers.

In addition, the decisions by a large number of retailers (varying in terms of size and demand) to source supplies from Australian producers and manufacturers play a pivotal role in the viability of many smaller primary producers and the continuing health of the Australian food manufacturing sector.

The food and beverage manufacturing industry is the largest component of the Australian manufacturing industry (according to total income), comprising approximately 21% of the industry. Similarly, the food wholesaling industry comprises approximately 16% of the total wholesale trade, and is the second largest component in the Australian wholesaling industry behind machinery and equipment wholesaling.⁸

In addition to the above industries, which are clearly linked with grocery retailing, there are a large number of niche industries which are heavily dependent on the grocery industry for their livelihood. These industries include:

- Commercial refrigeration
- Refrigerated road transport
- Refrigerated storage services.

The combined Gross Value Added (GVA) of retail trade, food, beverage and alcohol manufacturing, road transport, and transport services and storage was approximately equal to over 11% of Australian GDP in financial year 2006. This provides a broad indication of the strong economic contribution that retailing and its support services make to the national economy.

⁸ As at the end of 2004/05. ABS Cat. 81550.

2.1 Characteristics of the retail & grocery sector

2.1.1 Industry participants

Some of the major grocery retailers (MGRs) operating across Australia include:

- Woolworths
- Coles
- ALDI
- Pick 'n Pay (which now operates stores under the 'Franklins' banner).⁹

The alternative retailers to the major chain supermarkets are primarily SMEs, who represent the Metcash customer base. These SMEs are generally part of banner groups such as those listed below:

- Independent Grocers of Australia (IGA) including Ritchies IGA
- FoodWorks
- Four Square
- SPAR Australia.

2.1.2 Retail turnover & industry value-added

It is estimated that the grocery retail industry will account for 1.7% of total Australian GDP in 2006/07.¹⁰ Grocery retailing will nonetheless represent the largest component of retail industry revenues, currently accounting for approximately 29% of total retail expenditure.

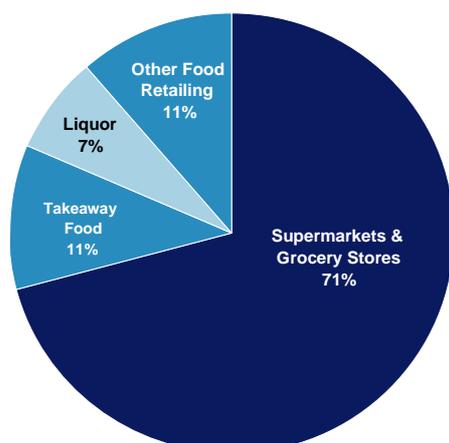
According to the ABS, total retail trade over the year to January 2007 equated to approximately \$217 billion, of which almost \$89 billion comprised total food retailing.¹¹ Grocery retailing represented over 70% of the food retailing market (refer to Figure 2.4).

⁹ Pick 'n' Pay re-entered the Australian market by purchasing some of the 70 Franklins stores (including 20 Fresco outlets), the remainder of which were bought by Woolworths, Coles and Metcash. IBISWorld 2007, Report G5111 "Supermarkets and Other Grocery (except convenience) Stores in Australia" 30 January 2007, p. 49.

¹⁰ Gross Value Added (GVA) of the retail trade industry to Australian GDP in 2006 was 5.8%, and grocery retailing represents 29% of this total value. According to these estimates, grocery retailing may contribute as much as 1.68% of GDP in 2006/07. However, there is an alternative (and more conservative) estimate calculated by IBISWorld that suggests the grocery retail industry will account for 0.7% of GDP. IBISWorld has not published or made available the basis of its calculation.

¹¹ Seasonally adjusted, Flow data. ABS, Cat. 850101.

Figure 2.4: Breakdown of food retailing turnover in the year to January 2007



Source: ABS Cat.8501019

The revenue generated by the supermarket and grocery sector in the year to January 2007 was estimated at \$63 billion.¹²

However, the total market for supermarket and grocery goods including other specialist stores is likely to be worth up to \$74 billion.¹³ This estimate is based on the suggestions by IBISWorld that the supermarket and grocery industry (in its strictest definition) accounts for about 85% of supermarket and grocery items, with the remaining 15% derived from sales by other niche retailers.

Industry Value-Added (IVA) refers to the revenue generated by the operations of an industry, less the cost of goods and services used in producing that revenue. Therefore, this statistic highlights the economic contribution of the supermarket and grocery industry separate from all supporting inputs that help generate final retail turnover figure.

According to estimates derived from ABS figures, IVA from the overall retail industry in 2006/07 will be close to \$64 billion.¹⁴ Hence, IVA from the supermarket and grocery industry alone can be estimated at approximately \$18.6 billion in financial year 2007. This suggests that IVA from the supermarket industry is equivalent to approximately 29.5% of total annual revenues generated in the industry.¹⁵

¹² ABS, Cat. 8501019. However, IBISWorld suggests that grocery retailing accounted for \$57.3 billion in the financial year 2006 which represents a 5.6% lower estimate than that given by ABS data. This may be a result of classification differences or use of original rather than seasonally adjusted data.

¹³ According to IBISWorld estimates, expenditure categorised under supermarket and grocery sector turnover is actually closer to 85% of the total supermarket and grocery spending in the economy. Therefore, where revenues are estimated at \$63 billion by the ABS, this would suggest that total revenues were closer to \$74 billion.

¹⁴ ABS, Cat. 81550 provides Industry Value-Added statistics from 2001-02 to 2004-05, with an average growth rate of 8.2% per annum in the retail trade sector. This average annual growth rate has been applied to 2004-05 figures to extrapolate the value of Industry Value-Added into 2006-07.

¹⁵ Where supermarket and grocery industry revenues equal \$63 billion, \$18.6 billion in value-add constitutes approximately 29.5%. Where total supermarket and grocery industry revenues equal \$74 billion, this value-added statistic falls to approximately 25%. According to ABS Cat. 81550, "Food Retailing" in 2004-05 constituted approximately 31% of the retail trade value-added.

However, the retail grocery industry is a mature industry in which margins have generally remained low and stable, and where volume is what generates profitability. Consequently, it is estimated by IBISWorld that the Industry Gross Product of the supermarket and grocery industry will grow at a modest average real annualised rate of 1.5% per annum, in comparison to anticipated Australian economic growth of 3.2% per annum, in real terms.¹⁶ Recent trends suggest that the MGRs are increasingly entering other markets (such as liquor, petrol, hotels, pubs and gaming) in order to grow sales and total earnings.

A summary of the information provided on this page is outlined in the Figure 2.5 below.

Figure 2.5: Summary of economic information relating to the supermarket and grocery industry

Economic Information – Supermarket & Grocery Industry	Data Results
Revenues – supermarket & grocery industry (according to ABS definition) – – IBISWorld indicates this value is 85% of Total Revenues	\$63 billion
Total Revenues – total market for supermarket & grocery goods	\$74 billion
Industry Value-Added – supermarket & grocery industry – equal to 29.5% of Revenues	\$19 billion
Industry Gross Product – supermarket & grocery industry growth rate – lower than predicted Australian GDP growth of 3.2%	1.5%

However, the *ACNielsen Grocery Report 2006* indicated that the grocery sector outlook remained “cautiously optimistic” with the annual growth trend expected to move steadily towards 5% (nominal, or approximately 2.5% real), following two years of average growth sitting close to 4% per annum (nominal).

2.1.3 Retailer numbers & geographic distribution

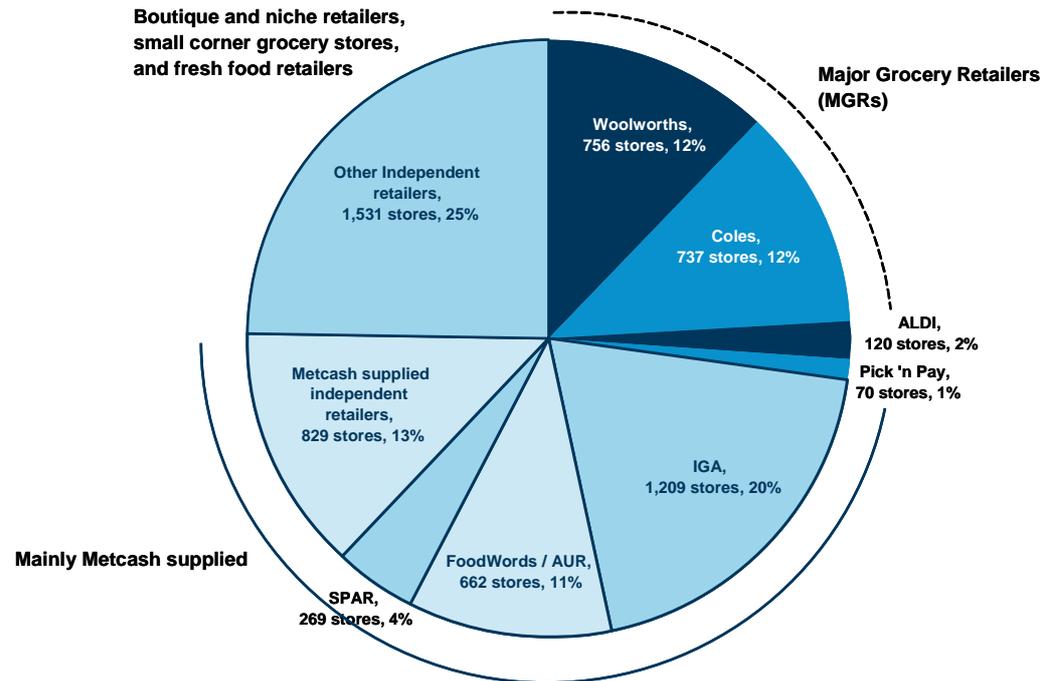
It is estimated that approximately 6,183 grocery retailing stores operate nationwide.¹⁷ Figure 2.6 provides an indication of the distribution of these stores between different operators and banner groups. All those segments outlined in dark blue indicate independent grocery stores.

The MGRs have a low percentage share of total stores but a very high share of sales; whereas the independent retailers have a high percentage of stores but a lower share of total sales. Combined, the MGRs constitute approximately 27% of the total number of grocery stores nationwide, although they account for approximately 80% of total sales revenue. IBISWorld highlights that this phenomenon is related to the size of stores and the buying strength of these major chain operators. For example, large property and shopping mall developers are not often willing to lease to independent retailers with the majority of prime sites or anchor tenancies going to MGRs for a variety of reasons.

¹⁶ IBISWorld 2007, Report G5111, p. 10.

¹⁷ This figure is approximately 40% larger than ABS estimates. However, industry analysis suggests that ABS and IBISWorld data which claims approximately 4,350 grocery stores operate Australia-wide may underestimate the number of grocery retailing stores on a national level. This may be due to lack of participation in ABS business surveys by smaller and especially remote businesses and the categorisation of “grocery” potentially not including small general corner and convenience stores which are primarily grocery providers, green grocers expanding into provision of grocery goods, and niche or boutique grocery providers. This higher figure is an estimate that has been generated from combining IBISWorld, Metcash, Woolworths, Coles and other publicly available information.

Figure 2.6: Breakdown of store numbers and percentage of stores by operator across Australia



Source: ABS, IBISWorld, Metcash, Coles and Woolworths 2006 Annual Reports

Grocery stores are spread across Australia approximately in proportion with demographic trends such as geographic distribution and population growth. The general geographic distribution of retail turnover or expenditure between the States and Territories as of January 2007, is shown in Figure 2.7.

Figure 2.7: Geographic spread of population, grocery stores and retail trade



Source: IBISWorld, ABS Cats. 850104 & 310104

NSW and Victoria, the two largest states by population, have a lower proportion of grocery stores in comparison to the level of retail trade and population they represent. The reverse is true in Queensland and South Australia. This phenomenon is related to the fact that fewer larger stores operate in metropolitan areas, whereas a larger number of smaller stores operate in states with highly dispersed rural and regional centres. For example, MGRs continue to be most dominant in the larger states such as NSW, with 84.6% market share in terms of retail turnover as at September 2006.¹⁸

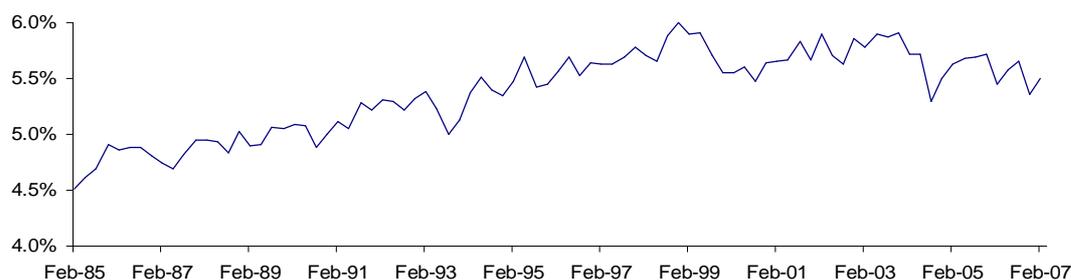
¹⁸ ACNielsen Grocery Report 2006, p. 12.

2.1.4 Employment Contribution

The retail industry is the largest employer in the Australian economy, employing approximately 14.4% of the total Australian labour force. In total, the retail industry employs approximately 1.5 million people or approximately 1.15 FTEs.¹⁹

Employment in the food retailing industry has remained a relatively steady proportion of the total Australian labour force, although it has exhibited a mild increasing trend over the past two decades, as shown in Figure 2.8. The growth of food retailing has occurred at a time where industries such as motor vehicle retailing and communication services have declined as a proportion of the total labour force.

Figure 2.8: Food retailing employment as a proportion of the total labour force



Source: ABS Cat. 6291006

In addition, a recent article in *BRW* indicated that MGRs have reduced their employee numbers whilst increasing turnover. The article from late 2006 stated that:

*"In spite of increasing its revenue by 75 per cent since 2001, Woolworths has cut its workforce by 27% or 35,592 people [over the past 5 years]. Retail rival Coles has also slashed its workforce over the past five years, down from 160,000 in 2001 to 94,000...[in 2006]."*²⁰

This suggests that SMEs may be playing an increasingly important role in relation to employment growth in the supermarket and grocery industry, and employing a growing percentage of total food retailing employment.

IBISWorld estimates that the grocery retailing sector will employ approximately 253,100 FTEs in 2006/07. ABS suggests that as at February 2007, the supermarket and grocery retailing industry employs approximately 397,198 employees (full-time and part-time) or 26.5% of total retail employment.²¹ Overall, the grocery retailing industry alone employs approximately 3.8% of Australia's total labour force.²² Approximately 51% of employees work in a full-time capacity in the supermarket and grocery retail industry, with the remainder employed through a part-time or casual basis.²³

¹⁹ As at February 2007. ABS Cat. 6291.0.55.003, Table 4. FTEs calculated on the basis of full-time employees plus 50% of part-time employees. This is the calculation technique used by the ABS.

²⁰ Thomson J. (2006), "Lean and Hungry at Work", *Business Review Weekly*, November 9-December 13, 2006.

²¹ ABS, Cat. 6291006. This figure is based on supermarket and grocery retail employment constituting 70% of total food retailing employment figures. Further to this, an alternative calculation suggests that the proportion of total retail FTEs that the supermarket and grocery industry represents (according to FTEs) is closer to 22%.

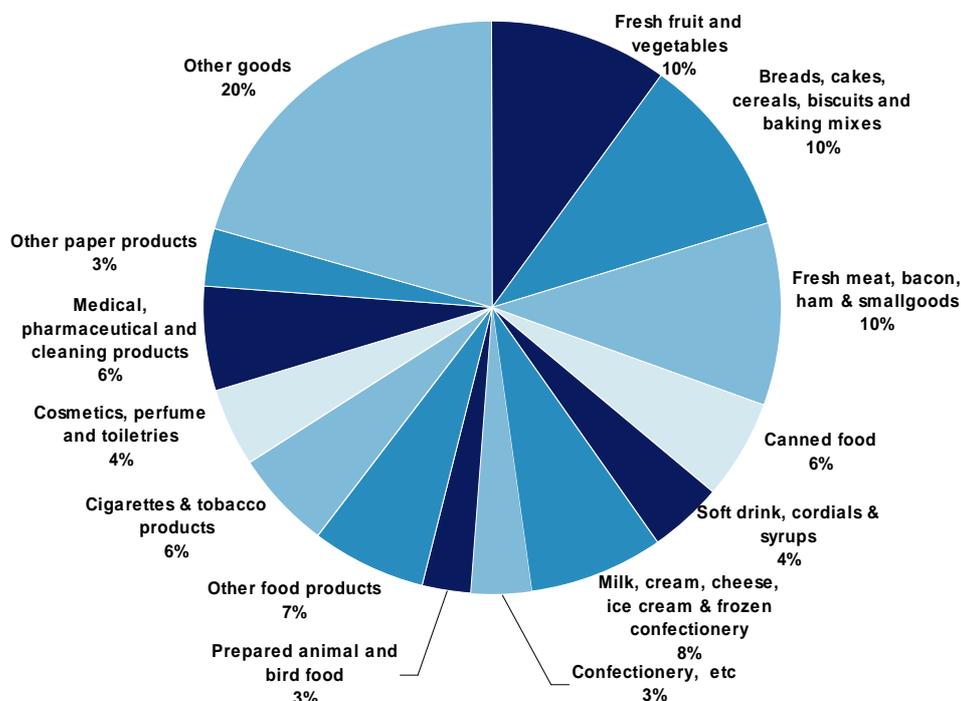
²² ABS, Cat. 6291006.

²³ Ibid.

2.1.5 Product Range

The industry offers a variety of brand packaged and fresh grocery goods. An indication of the product share in the supermarket and grocery sector is provided in Figure 2.9 below.

Figure 2.9: Product segmentation and share of revenues in grocery retailing



Source: IBISWorld

In addition, while a considerable share of grocery merchandise is a product of Australia (as defined by the *Trades Practices Act 1974*),²⁴ imported products and international suppliers are becoming a more important part of the grocery industry. Retailers are pursuing importation of produce to build margins and control costs, motivations which are similarly driving the strategy to develop private labels.

MGRs are also increasingly stocking products that were previously only found in specialty stores (eg Asian and Mediterranean ingredients). MGRs are gradually sourcing a higher proportion of produce from international, rather than Australian, suppliers. This trend could potentially affect the success and continued livelihood of local producers and manufacturers.

²⁴ Section 65AC of the TPA outlines the "Test for representations that goods are product of/produce of a country". It states that if:

(a) a corporation makes a representation that goods are the produce of a particular country (whether the representation uses the words "product of", "produce of" or any other grammatical variation of the word "produce"); and
 (b) the country was the country of origin of each significant ingredient or significant component of the goods; and
 (c) all, or virtually all, processes involved in the production or manufacture happened in that country;

the corporation does not contravene section 52, paragraph 53(a) or (eb) or paragraph 75AZC(1)(a) or (i) by reason only of making the representation. That is, if these conditions are satisfied, the representation will not be considered to be misleading or deceptive in nature.

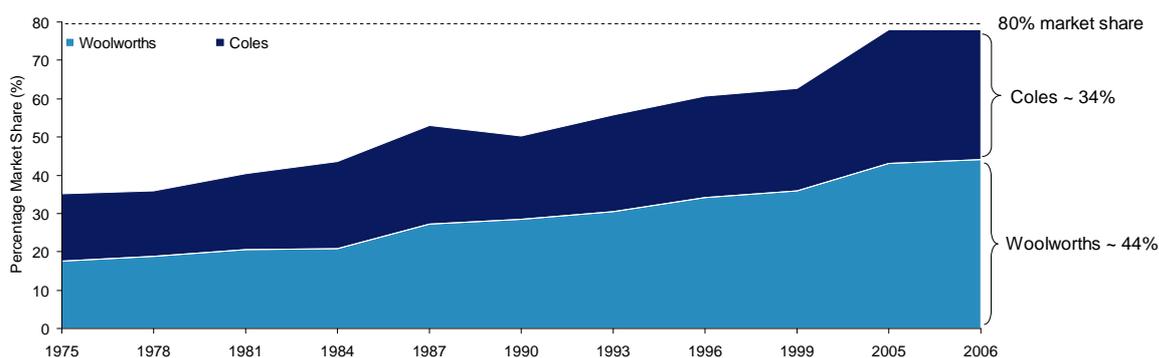
2.2 Recent Trends

Over the past 30 years, the supermarket industry has become highly price competitive for a limited number of high volume headline products (but often with minimal discounting of lower volume products), effectively 'training' consumers to be price conscious. Other major retailers market themselves on having lower prices for their whole range of products on a permanent basis. This has seen MGRs gain market share and increase their economies of scale, resulting in significant rationalisation of industry enterprise numbers. This trend has been reinforced due to the large industry players growing via acquisition and new store openings, and with independent grocers and supermarkets joining together to form co-operatives or buying groups.

2.2.1 Market share concentration

Since the early 1990s, the supermarket industry has undergone significant restructuring. Australia's grocery market has become one of the most concentrated in the world. Current ACNielsen estimates indicate that the two major supermarket chains, Woolworths and Coles, have approximately 78-79% of the market.²⁵ The Australian market share growth of these two key MGRs over the past three decades has been significant – growing from approximately 35% to around 79%, as shown below in Figure 2.10.

Figure 2.10: Growth in market share of Woolworths and Coles, 1975-2006



Source: *Retail World, ACNielsen*

This market dominance entails certain benefits and risks, as shown below:

- Benefits – including economies of scale and reduced unit costs for businesses, hopefully translating into lower prices for consumers
- Risks – that such powerful companies might misuse their position against suppliers and smaller competitors.

Anecdotal evidence suggests that the dominance of the MGRs is continuing to grow, especially due to their entrance into the fuel market through petrol provider alliances that have allowed the major retailers to open a large number of convenience stores. However, the MGRs often report lower market share statistics using a 'whole-of-stomach-approach'.

²⁵ ACNielsen Grocery Report 2006, p. 12.

This approach includes takeaway food and other food retailing, liquor products, fuel and all other products that consumers eat across the economy to calculate market share rather than on the basis of supermarket consumption alone.

In support of the growing dominance of the MGRs, *The Australian Financial Review* recently indicated that Woolworths' dominance was growing in the industry and that its cash registers alone collected approximately 18.8% of nationwide average monthly retail sales (ie includes non-grocery retail expenditure).²⁶

The degree to which Australia's retail grocery sector is one of the most concentrated in the developed world is emphasised by Figure 2.11. The Australian grocery market is a significantly smaller market than the USA and the UK, and is therefore generally more prone to greater concentration. A publication by the ABARE in May 2005 indicated that market share of the top five competitors in the retail food markets of countries such as Canada and Singapore were as low as 55% and even lower in South-East Asian nations such as Thailand, Philippines and Malaysia.²⁷

Figure 2.11: International comparison of grocery market share concentration

Country	Market Share			Major Players
	Top 2	No. 3, 4 & 5	Top 5	
Australia	79% ²⁸	+7%	86% ²⁹	Woolworths, Coles, Ritchies, ALDI, Franklins
United Kingdom ³⁰	48%	+32%	80%	Tesco, Sainsbury, Asda (Wal-Mart), Morrisons, Somerfield
USA	20% ³¹	+22%	42% ³²	Wal-Mart, Kroger Co

In a market where the top two players hold 80% market share, there is likely to be a different supplier-retailer competitive positioning than in a market where the top two players hold 50% market share. The expected result of such a significant degree of grocery market share concentration, such as that which exists in Australia, is a shift in price negotiating power towards large retailers (ie the MGRs).

In the UK, the Office of Fair Trading has continued to come under heavy attacks in recent years from consumer groups and the government's National Audit Office for not taking a proactive approach to the effect the big four supermarkets have on the grocery sector.³³ Concerns in the USA about Wal-Mart's dominance are also well publicised.

²⁶ Jury, A. 2007, "ACCC obstacle on road to domination", *The Australian Financial Review*, 18 April 2007, p. 49.

²⁷ Jacenko, A. & Gunasekera, D. 2005, "Australia's retail food sector: Some preliminary observations", ABARE, *The Pacific Food System Outlook 2005-06*, Kunming, China 11-13 May 2005, p. 3.

²⁸ ACNielsen *Grocery Report 2006*, p. 12. On the basis that Woolworths and Coles have appropriated most of the remaining Franklins stores, the top 2 major retailers now cover the vast majority of the previously top 3 retailer market share.

²⁹ This figure is sourced from 2004. Market Share Matrix Project, 2004. Available at http://www.marketsharematrix.org/pdf/RANKING_concentration_retailers_Oceania_per_country_CORRECTED.pdf, accessed 12 April 2007.

³⁰ TNSinfo, "12 week Grocer Share of Trade to 25th February 2007.xls", available at <https://www.tnsinfo.com/TNSInfo/Rooms/DisplayPages/LayoutInitial?Container=com.webridge.entity.Entity%5B0ID%5B23CDADC3E5AA1C42A6EC5DE7CEE926CD%5D%5D>, accessed on 12 April 2007.

³¹ Wal-Mart market share is estimated at approximately 15.5% and is approximately 4 times as large as its closest rival, Kroger Co.. Sourced from Planet Retail, "North American Retailers Combat Wal-Mart with Diverse Store Formats, According to Planet Retail's Latest Ranking", 31 August 2006. Available at <http://www.planetretail.net/Home/PressReleases/PressRelease.aspx?PressReleaseID=48709>, accessed 12 April 2007.

³² Mitchell, S. 2003, Institute for Local Self-Reliance, "10 reasons why Vermont's homegrown economy matters, and 50 proven ways to revive it", Preservation Trust of Vermont, October 2003

³³ BBC News, "Supermarkets face dominance probe", 9 March 2006.

However, the nature of the dominance of the top two major retailers in Australia is stronger. There are suggestions that Coles and Woolworths do not often compete in a single shopping area and effectively provide a similar offering to consumers (ie promote themselves as providers of fresh grocery products with low prices on a selection of core goods). This indicates that potentially there should be greater concern and interest in Australia in the future implications of such high market concentration on competition and consumer welfare in the supermarket and grocery market.

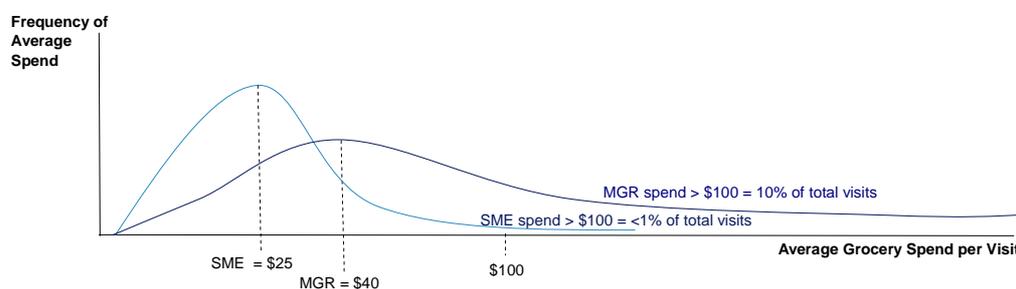
2.2.2 Spending patterns

It is anticipated that spending patterns differ considerably between independent retailers and MGRs. Anecdotal evidence suggests that consumers spend smaller amounts more frequently at independent local retailers, with the average spend being less than \$30.³⁴

However, the average spend at a major chain retailer is likely to be larger, but less frequent. Average weekly household expenditure on food and non-alcoholic beverages is estimated to be equal to approximately \$145, and this figure is higher for families with children.³⁵ It is estimated that households that spend a larger proportion of this figure in a single visit to the supermarket are more likely to do so at an MGR.

An example of the potential distribution of grocery spending at independent retailers and major chain stores, shown below in Figure 2.12, may better illustrate the possible difference in spending patterns that exist between SMEs and MGRs.

Figure 2.12: Comparison of average spending patterns at SMEs and MGRs



Source: PricewaterhouseCoopers

³⁴ AAP 2003, "Supa IGA builds on Metcash petrol deal", *The Sydney Morning Herald*, October 23, 2003. Available at: www.smh.com.au/articles/2003/10/22/1066631498004.html.

³⁵ ABS Cat. 6302001. Figure calculated according to average weekly earnings as at November 2006, multiplied by 17.1% (food and non-alcoholic beverages component of household expenditure, referred to earlier in the report).

Box 1: The “Third Force” in grocery retailing

Metcash Ltd – IGA-Distribution & Campbell’s Wholesale

Metcash Ltd generated \$8.2 billion in sales in financial year 2006 and has established itself as a viable “third force” in the grocery sector through its IGA-Distribution (IGA>D) and Campbell’s Wholesale divisions.³⁶ Metcash is primarily a grocery wholesaling and distribution business that has created a strong alliance with the FoodWorks and IGA networks, other independent retailing banner groups and individual grocery stores, actively promoting itself as the “champion of the independent retailer”.

Metcash assists in the supply of marketing and distribution expertise to over 2,700 independent grocery stores in NSW, ACT, Victoria, Queensland, South Australia and Western Australia. It also operates 12 major distribution centres through IGA>D to deliver dry, chilled and frozen groceries.

In addition to IGA>D, Metcash also operates the Campbell’s Wholesale business. Whilst this business segment focuses on convenience stores which would be considered outside the supermarket and grocery sector, its Cash & Carry warehouses often service smaller independent grocery stores, or traditionally more remote corner and general stores who buy in quantities that cannot be economically serviced through a full case grocery or liquor distribution centre and require a total supply solution.³⁷

Metcash has 21 Cash & Carry warehouses and 22 regional wholesale distribution warehouses across NSW, Victoria, Queensland, South Australia and the Northern Territory, stocking a broad range of groceries, liquor and confectionery.

Entering the retailing market

Metcash has typically owned between 3-10% of independent grocery stores under IGA, FoodWorks or other banner groups; primarily new start-ups, acquisitions or purchases from existing independent retailers. In November 2005, Metcash bought 62 Action stores through the acquisition of the Foodland Australian businesses. The majority of these stores were rebranded under the IGA banner and 50 of these were resold in late 2006 to independent retailers. Metcash retained 12 stores in Perth, WA. However, recent broker reports suggest that these stores are now ready to be sold when an appropriate acquiror is identified.



The Champion of the Independent Retailer

As the wholesale and distribution arm of independent retailers, Metcash can effectively balance the bargaining power of the MGRs. It allows independent retailers to purchase as a single entity at competitive wholesale prices and gain the benefit of certain economies of scale that make independent retailing financially viable.

Around 60% of all independent retailers (by store numbers) are directly supplied by Metcash, however approximately 95% of independent grocery turnover is potentially sourced from Metcash. Despite this dominant position as a wholesaler and distributor for independent grocery retailers, Metcash does not require exclusivity of supply for IGA supermarkets. This effectively allows independent retailers to purchase products from alternative and local suppliers, such as fresh produce from local farmers. The benefit of this flexibility is that SMEs can:

- customise store layout and tailor product choice to match local tastes
- provide access to local and seasonal produce and continuing support for local industries and producers.

PwC’s 2007 publication of *Retail & Consumer Outlook Australia – Changes in play* highlights that “distribution networks servicing independent retailers will not only survive but grow stronger”, suggesting that the recent success of Metcash will continue into the future. This is particularly true where independent retailers are attempting to strengthen their position in the marketplace and challenge the dominance of the MGRs by tailoring their stores and product offering to maximise customer convenience and satisfaction.

³⁶ Metcash also includes Australian Liquor Markets (ALM) which accounts for approximately 29% of sales. However, this division is of less relevance to the independent grocery retailing sector.

³⁷ Metcash Annual Report 2006, p. 10.

2.2.3 Retailing strategies

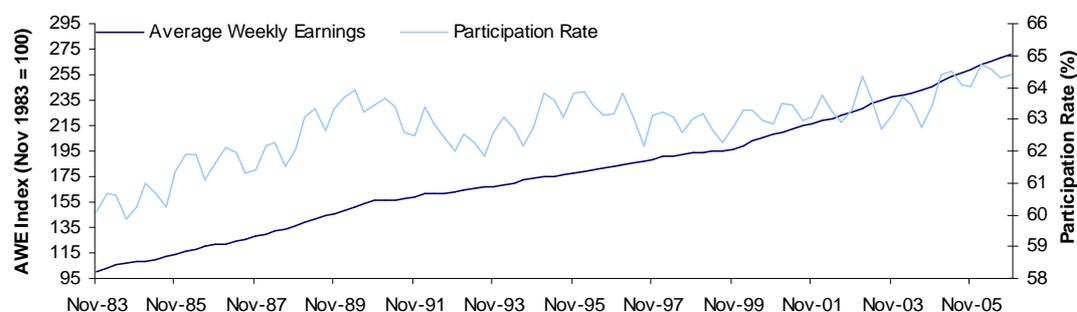
Fresh food retailing

IBISWorld suggests that the MGRs are tapping into the "more than just a grocery store" image to improve sales and profitability, by offering a broader range of products with a higher gross profit margin than dry groceries. This is best exemplified through the growth in high profit non-grocery goods (ie fresh foods) at MGR stores and the strong marketing campaign by Woolworths of "The Fresh Food People". It is estimated that fresh foods now account for between 20-25% of grocery sales.³⁸

Home meal solutions

Australia is seeing a shift to smaller household sizes, increased income levels, longer working hours and increased workforce participation, partly demonstrated in Figure 2.13.

Figure 2.13: Trend in AWE and the Participation Rate



Source: ABS Cat. 6302001 & 6291002

These trends have all contributed to the growth in frozen or pre-prepared meals in the grocery retailing market.

It is estimated by IBISWorld that approximately 60% of sales between 4pm and 7pm are via express checkouts and that the frozen meal market has grown in value by approximately \$100 million over the past 5 years. As a result of this consumer demand for pre-made dinners, MGRs are increasingly developing their selection of Home Meal Replacement products (eg Meal Solutions) and are relocating frozen food sections to the front of the store to allow what is now a \$728 billion 'dinner tonight' market to make purchases instantly. Whilst pre-made meals save time for consumers, they come at a greater cost than the sum of the components required for a self prepared meal, thereby effectively increasing retailer sales.

The growth in private labels

In recent years, as a means to increase margins, contain product range and gain a better insight into manufacturing costs, MGRs have begun to attract customers introducing 'housebrand' products and private labels.

³⁸ IBISWorld 2007, Report G5111, p. 46.

MGRs often encourage the third, fourth and fifth-ranked manufacturer to shift to a private label arrangement as part of an MGR strategy to narrow product ranges and save on the costs associated with stocking too large a range of product lines.

ABARE suggests that MGRs are likely to gain financially from this introduction, as the profits on housebrand products are substantially higher than on national brands.³⁹ It has also been suggested that the MGRs will not be deterred from entering grocery categories where national brands are well-established. As a result, the availability of shelf-space for national brands and the profitability of the Australian food manufacturing business may be affected, as IBISWorld and ABARE estimate that this high margin segment is expected to represent approximately 30% of supermarket sales.⁴⁰

The growth in private labels is supported by the *ACNielsen Grocery Report 2006*, stating:

“we are starting to see private label gain share within packaged grocery...the tiered private label strategies of Coles and Woolworths are beginning to gain traction.”

Sales of private label packaged grocery goods grew by 7.1% (to \$5.8 billion) over the year to December 2006, while overall packaged grocery sales grew by 5.8%. Although private label products grew at a faster rate than the market overall, the private label share of total grocery sales remained essentially unchanged considering that it was growing from a much smaller base than the more mature component of the grocery market.⁴¹

Whilst it is evident that early housebrand offers sought to provide basic quality grocery items which could be sold at low prices, IBISWorld highlights that industry focus has shifted. MGRs are placing major resources behind the development of their own private labels which are sustainable, shopper relevant and differentiated from similar goods on the market. For example, between 10-15% of Coles' total product lines are private labels, and it is estimated that approximately 95% of ALDI products are housebrand products.

Independent retailers have also developed a housebrand in the form of the “Black & Gold” label. Whilst private label products are available at independent grocery stores, there has not been a concerted effort to increase sales of housebrand products as a proportion of total grocery sales in the way the MGRs have pursued this strategy.

³⁹ Jacenko, A. & Gunasekera, D. 2005, p. 5. ABARE indicates that gross margins on housebrand products are 2% greater than on national brands

⁴⁰ Jacenko, A. & Gunasekera, D. 2005, op. cit., p. 5.

⁴¹ ACNielsen *Market Information Digest* data, quoted in PricewaterhouseCoopers' *2007 Retail & Consumer Outlook Australia – Changes in play*, p. 122.

Increased market segmentation & differences in product range

The range of merchandise offered by the supermarket and grocery industry is also largely segmented into two categories:

- Discount retailers, such as ALDI, offer consumers a narrower merchandise selection of mainly staples to contain costs and present competitive pricing; and
- Larger operators, such as Coles and Woolworths, offer an extensive range of branded merchandise along with their own private labels and housebrands. For example, ALDI offers a product range of approximately 600 lines, whereas Coles offers closer to 30,000 product lines.

Industry analysis has found operators (ie both MGRs and SMEs) targeting the lower end of the market have suffered as a result of the introduction of ALDI into Australia in 2001. IBISWorld claims that “independent operators are also likely to have been adversely affected” from ALDI’s success.

Petrol provider alliances

As mentioned previously, the entrance of the MGRs into the fuel market through petrol provider alliances has allowed the major retailers to open a large number of convenience stores and increase their offering to customers. This has also been an attractive growth strategy considering that there are higher margins on grocery goods at convenience stores due to the premium for the “convenience factor”.

In late 2003, research by Roy Morgan indicated that Woolworths experienced a 6% increase in the number of customers following its alliance with Caltex.⁴² At that time, surveys conducted by Roy Morgan found that around 50% of grocery shoppers (or 2.2 million people) viewed discount petrol as a significant incentive to shop at the associated MGR.⁴³

Choice of location

As a general comment, most MGR stores are located in metropolitan and larger regional shopping malls, whilst most smaller local shopping centres and strips are usually supplied by independent retailers. Based on current store locations, it would appear that each retailer generally has a preferred location or strategy, demonstrating the segmentation of the grocery retailing market:

- Woolworths and Coles generally prefer large metropolitan shopping malls which usually have large parking lots, forming anchor tenants for these malls
- ALDI is generally known for choosing standalone warehouse-style sites on the fringe or edge of major malls or suburban areas
- IGA and smaller independent stores generally form part of suburban commercial districts such as strip centres or “high street” town centres.

⁴² IBISWorld 2007, Report G5111 p. 38.

⁴³ Ibid.

These traditional location outcomes are largely a result of the availability of property and retail space, the capacity of grocery operators to pay different levels of rent, and the preferences of developers. For example, whilst independent retailers view becoming an anchor tenant in a large shopping mall as desirable, they are not often given access to these prime sites. This appears to be due to the fact that large property and shopping mall developers generally prefer the well-known MGRs and perceive their having a greater degree of “pulling power” to bring customers towards the other speciality shops.

These traditional locations are likely to change over time. In the quest for earnings growth in a mature market, the choice of store location is evolving so that MGRs are now seen to be moving into non-traditional store locations using more compact formats to open ‘express’ or ‘convenience-style’ outlets, and Supa-IGA stores are entering large shopping malls as secondary grocery store tenants.

Independent retailers seek to provide a service of convenience to a wide range of smaller community areas across Australia, especially in remote areas. Their smaller size, more community-based retail environments with a more restricted range of products comprise the majority of grocery stores and offer a unique customer offering, contributing to consumer welfare and choice.



Box 2: Competition in the grocery retail industry

The current objectives of competition legislation & its impact on SMEs

The Australian legislation and legal system has a history of seeking to protect small businesses from anti-competitive and “unconscionable” conduct through the *Trade Practices Act 1974* (TPA), whilst balancing this objective with the aim to promote competition and economic freedom.

The primary objective of the legislation is “the protection of competition rather than the protection of any particular competitors, such as small business”,⁴⁴ with the aim to prohibit a dominant market participant from taking advantage of its market power to injure or eliminate its competitors.⁴⁵

The Trade Practices Committee of the Law Council of Australia released a submission in March 2007 which inquired into the effectiveness of the TPA to protect small businesses and discussed potential reforms. The submission generally confirmed that the TPA efficiently promotes competition and fair trading among all businesses to provide Australian consumers with the benefits of competition, and adequately protects small businesses from the misuse of market power.

Concerns among SMEs regarding the nature and structure of the grocery retail sector

The economies of scale and bargaining power of MGRs can lead to lower unit costs, which potentially benefit consumers through lower grocery prices. However, concerns exist that the oligopolistic nature of the sector gives MGRs a substantial degree of financial power to offer some highly competitive prices (that can disadvantage SMEs), and to raise the prices of non-core goods.

For example, a consortium of small business associations in Australia argued in several submissions to the Dawson Committee for Trade Practices Review that dominant firms often sell products at very low prices with a view to driving out competitors and then charge higher prices later. This would adversely affect Australian consumers and is believed to contribute to a significant and measurable increase in inflation due to higher grocery prices.

The issue of market concentration in the retail grocery sector is highly relevant to the operation of the TPA, which contains provisions to prevent mergers that substantially undermine effective competition. Small businesses argue that the nature of the TPA and its application means that minor or so called “creeping acquisitions” by MGRs, (ie purchases of existing independently-owned stores or the opening of new stores) are not precluded or actively prevented. This argument is supported by Alan Moss who states that where “A large part of the problem is that there is no effective anti-trust/anti-monopoly legislation in Australia...the [ACCC] has no power, or policy interest, to prevent a business from simply growing enormous and totally dominating the market place.”⁴⁶ The Law Council of Australia further highlights that regulators have not actively applied the legislation to enhance competition. In its submission to the TPA Review Committee in 2002, it stated that “[t]he issue of greatest concern for the Council in relation to the merger provisions is the lack of transparency and accountability associated with the informal clearance process. In our view, s50...has ceased to be a law by which anti-competitive mergers are subject to judicial examination and order”.⁴⁷

Studies by Dr. Kenneth Stone, an economics professor at Iowa State University, support the idea that retail sales growth is a “zero-sum game”. That is, gains in sales for MGRs come at the expense of sales losses for existing businesses, as grocery sales grow incrementally as population and incomes grow, not proportionately.⁴⁸ Therefore, the opening of new MGR stores in areas not currently serviced by MGRs generally result in creeping market share and monopolisation of local markets (as the MGRs do not often compete directly in any one area). NARGA believes that this behaviour is likely to have a long-term detrimental impact on market concentration and consumer welfare.

These concerns and the unique nature of the grocery retailing sector both highlight the importance of ensuring that the application of competition legislation is appropriate to the needs of particular competition environments. Doing so will enhance consumer welfare and choice, contain food price inflation, and ensure that effective competition is encouraged in the grocery retailing sector.

⁴⁴ Submission by the Trade Practices Committee of the Business Law Section of the Law Council of Australia to the Senate Economics References Committee, 2007, “Inquiry into the effectiveness of the *Trade Practices Act 1974* in protecting small business”, 12 March 2007, p 8 (s2.2).

⁴⁵ Ibid.

⁴⁶ Moss, A. 2007, *Report of the 2006/07 Review of the Shop Trading Hours Act 1977*, February 2007, p. 27.

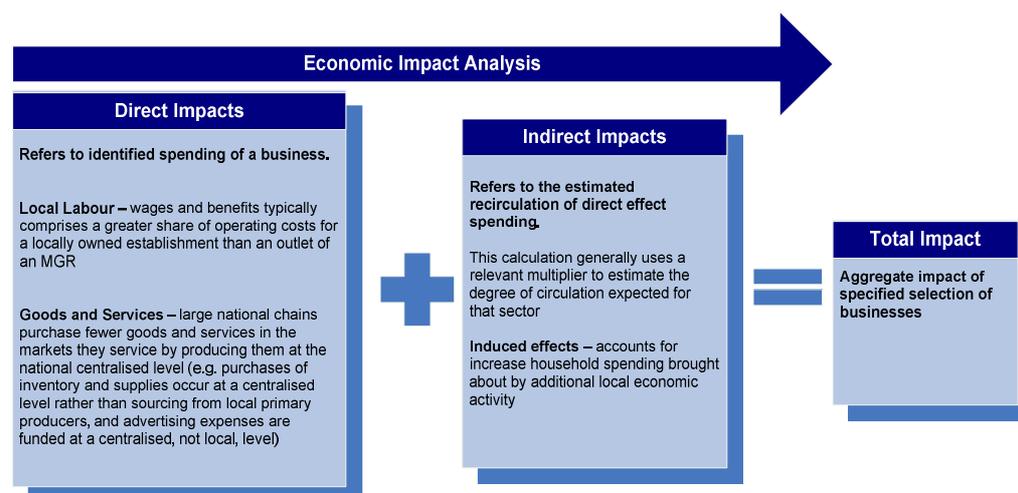
2.1 National economic impacts

The total economic impact of independent retailers can be identified through the analysis of the direct effect of the initial increase in revenues or demand and the indirect (or “flow-on”) effects. The flow-on effects result from the linkages between industries in the economy.

- *Direct impacts* are the revenues generated as a result of the operations proper, which are subsequently distributed (eg as wages payments to supermarket employees)
- *Indirect impacts* refer to the additional flow-on employment, income, imports, output or revenues generated by a particular industry and its distributions (eg indirect effects take into account the economic effects of expenditure by supermarket employees on additional local services, and local spending by accountants as a result of receiving fees from local grocery retailers for their services)

The diagram below provides an indication of the manner in which the direct and indirect effects of grocery SME activity demonstrates their economic impact at an aggregate level. Figure 2.14 also highlights that the economic impacts of SMEs tend to be stronger at a local and State level and thereby more geographically contained than those of MGRs. This is relevant to their impact on the WA economy which will be discussed in Section 5.3 of this report.

Figure 2.14: Measuring aggregate economic impacts of SMEs



By identifying suppliers to the retail trade industry, it is possible also to understand the broad impact of retail trade on other industries. In 1996/97, the retail trade sector procured supplies from 90 industries (of a total of 106 at the time as defined by the ABS) valued at over \$23.3 billion.⁴⁹

⁴⁷ Submission by the Business Law Committee of the Law Council of Australia to the Trade Practices Act Review Committee, 2002, “Review of the Competition Provisions of the *Trade Practices Act 1974*”, June 2007, p 54 (s5.1).

⁴⁸ Mitchell, S. 2003, op. cit., p. 5.

⁴⁹ ABS, Cat. 52090, Table 2.

The sectors which received over \$500 million input from the retail trade sector in 1996/97 were as follows (in order of importance):

- Legal, accounting etc services
- Communication services
- Property services
- Other business services
- Printing; services to printing
- Other repairs
- Publishing, recorded media etc
- Meat and meat products
- Banking
- Wholesale trade
- Motion picture, radio etc services.

Other important industries which benefit from the grocery retail industry in particular were mentioned earlier and include:

- Fresh fruit and vegetable production
- Food and beverage manufacturing
- Commercial refrigeration
- Refrigerated road transport
- Refrigerated storage service.



The intra-industry flows between retail trade and this diverse range of sectors emphasises the important flow-on effects of the retail trade industry, which acts as a proxy for understanding the effect of the grocery industry. A full list of intra-industry flows and their supply contribution to the retail trade sector is provided in the Appendix A.

In relation to the grocery industry, it is believed that SMEs generate significant economic benefits due to their large volume and their disproportionately high employment contribution as compared to their market share (ie grocery SMEs employ 57% of total grocery industry employees nationwide, although they hold only 20% market share).

At a nationwide level, the collective direct and indirect impacts of a dollar spent in grocery SMEs as a group are likely to be similar to those generated by a dollar spent at an MGR. However, of particular interest is the fact that independent grocery retailers promote the localised accumulation of wealth more strongly by sourcing a larger proportion of their inputs on a local basis, in particular service inputs such as accounting, legal and local media services. Once again, this is of particular interest to the benefits that the WA economy gains from independent retailers which are discussed in Section 5.3.

3 National economic impact of SMEs and grocery SMEs

Independent grocery stores are the product of investment by small entrepreneurs and contribute greatly to the economic prosperity of local communities. These grocery stores are often the anchor or hub of suburban centres, drawing customers to shopping areas and sustaining community life.

Small entrepreneurs and medium-sized businesses in the economy have consistently contributed towards building wealth in the Australian economy and were recently commended by the Federal Treasurer, Peter Costello, in his 2007 Budget Speech. It is estimated that the total wealth of family-owned businesses in 2006 was A\$4.3 trillion. A similar study undertaken in 2003 indicated total wealth was close to \$3.6 trillion, indicating a compound annual growth rate of 6.1%.⁵⁰

To provide some context for these values, family-owned businesses represent a greater value than total managed funds and ASX market capitalisation combined; the ASX as at January 2007 had a total domestic equity market capitalisation of \$1.42 trillion, whilst total FUM⁵¹ in the managed funds industry stood at \$1.3 trillion as at June 2006.⁵²

In addition, family involvement in small businesses and entrepreneurship is extensive. For example, microbusinesses (those businesses employing fewer than five people) accounted for 85% of the total number of small businesses in 1994/95, and only 6% of employing businesses with fewer than five people employed did not involve proprietors from the same family. Among small businesses with between 5 to 19 workers, still approximately 83% of the businesses involved family ownership.⁵³

The results of the *Family and Private Business Survey 2006* undertaken by RMIT University for the accounting group MGI further found that:

- family enterprises generate more than half of Australia's employment growth
- family enterprises account for approximately 40% of Australia's private sector output
- approximately half of Australia's top 500 private companies are family owned
- approximately half the family business owners see themselves working in the business beyond age 65 years
- approximately half the family business owners indicate that their retirement programs rely on superannuation.

These statistics give an indication of the positive economic benefits that family-owned enterprises contribute to the Australian economy, both in terms of employment and output, as well as from the perspective of the promotion of diligent work ethic and generation of wealth.

This is not to say that all grocery SMEs are family-owned enterprises. However, all grocery SMEs are independently owned, and a significant proportion of SMEs are family businesses and provide similar economic benefits to the national economy.

⁵⁰ MGI Australasia Media Release, 16 November 2006 *End of Dynasty for Family Businesses? - Survey*, p. 1. MGI's *Family and Private Business Survey 2006* was undertaken by RMIT University for the accounting group MGI.

⁵¹ Refer to funds under management.

⁵² ABS Cat. 5655.0, Managed Funds, Australia.

⁵³ ABS Cat. 4102.0, Australian Social Trends, 1997.

3.1 Characteristics of the retail & grocery sector

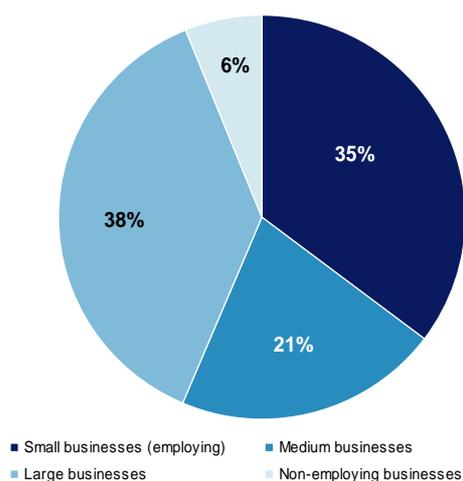
3.1.1 Retail Turnover & Industry Value-Added

It is estimated that independent grocery operators will have accounted for approximately \$15 billion in sales in the year to January 2007⁵⁴, with consumer spending at independent grocery retailers constituting around one in every five supermarket dollars, or 20% of the retail grocery market.

The exposure of independent retailers in the grocery retail market has also been increasing. According to ACNielsen, total banner group market share increased from 18.5% as at 30 April 2006 to 18.9% at the end of October,⁵⁵ reflecting some gains from the MGRs at a national level. *The Australian Financial Review* highlighted this growing awareness of independent retailers, quoting Citigroup estimates which suggested that IGA has collected 42% of foregone sales from the Coles Group due to the conversion of the Bi-Lo supermarket chain.⁵⁶

Figure 3.1 below shows the distribution of IVA in the retail trade sector as published in 2004/05 by the ABS.

Figure 3.1: Industry Value-Added by business size in the retail sector, 2004/05



Source: ABS, Cat. 81550 Australian Industry 2001-02 to 2004-05

⁵⁴ Assuming that independent retailers account for between 19-21% of supermarket and grocery sales (depending on whether \$68 billion or \$74 billion in total sales are assumed as mentioned previously).

⁵⁵ Metcash Broker Reports.

⁵⁶ Evans, S. 2007, "Bi-Lo failure costs \$350m", *The Australian Financial Review*, 17 April 2007, p. 14.

This demonstrates that the majority of IVA in the retail sector was contributed by SMEs. In particular, employing SMEs consisted of approximately 56% of the total IVA. Through their capacity to tailor their offering to local needs and demographics, and their attempt to customise their product range and store layout to the preferences of local shoppers, independent retailers are able to add value to their sales offering. The convenient “high street” location of grocery SMEs also contributes to their attraction to shoppers.

Box 3: The IGA Network

The Independent Grocers of Australia (IGA) is the largest independent retailer network which includes Ritchies IGA and FoodWorks. There are several other banner groups in the industry. These banner groups constitute between 85-95% of all independent retail sales on a nationwide basis.

IGA was brought to Australia from the United States by Davids Holdings in 1988 when 10 stores initially became members of IGA. Independent retailers are increasingly aware of the benefits of uniting under a single banner. As a result, there are currently 1,209 IGA stores in the country. Davids has changed its name to Metcash and the distribution side of the business changed to IGA-Distribution (IGA>D).

The stores supplied by IGA>D are grouped into three channels depending on their size, range and customer profile.

Channel 1: Supa IGA

Large format stores, carrying a full and large supermarket range. These stores primarily cater to shoppers who wish to purchase all of the grocery and fresh food requirements in one location.

Channel 2: IGA

Medium format stores that carry a mid-sized supermarket range. These stores are neighbourhood stores catering to shoppers who purchase less items, but do so more regularly.

Channel 3: IGA X-press

Small format stores which attract a convenience market with a concentration on high service. These stores supplement a full grocery shop and specifically target the shopping demographic in their area.

By being part of the IGA banner, the independent stores are able to buy groceries at more competitive prices. Storeowners also receive marketing and business programmes and guidance, fresh food specialist advice and IT support.

The Black & Gold brand was also launched in 1980 to compete in the housebrand market and now offers a wide range of products through independently owned supermarkets.

IGA provides a support system that strengthens independent supermarket operators and aims to provide customers with a cost-effective shopping alternative. In addition, IGA, and other similarly independent grocers, generally aim to achieve a “competitive edge” by investing more in their individual businesses to increase local market share and by positioning themselves as a leader in community support.

Source: IBISWorld, IGA website

3.1.2 Retailer Numbers & Growth

The ABS estimates that 1.12 million non-agricultural private sector small businesses operated in Australia during 2000/01, which represented 96% of all non-agricultural private sector businesses.⁵⁷ Similarly in 1999/2000, small enterprises in the retail trade sector (including non-employing) represented 96.8% of total retail trade businesses in Australia.⁵⁸ These figures demonstrate the strong economic contribution of small businesses in Australia.

Nationwide, approximately 4,500 independent grocery retailing stores operate and comprise 73% of all supermarket and grocery stores (as shown earlier in Figure 2.6).

Over 1,209 stores were operating under the IGA banner, the largest independent retailing banner group, as of mid-2006.⁵⁹ Over 39,000 square metres of selling space were added to the IGA brand by the opening of 44 new stores in 2005/06. More than 48 major refurbishments were completed during the year and the completion of 76 new independent stores is believed to be undergoing consideration for the end of financial year 2007.⁶⁰ FoodWorks, the other large independent banner group and Metcash's largest client also rebranded 350 stores in financial year 2006. During the next 12 months, it is estimated by Metcash that 37 new FoodWorks stores will be opened and 44 stores refurbished and expanded.

According to Metcash, sales increased by 6.3% for comparable IGA stores, and by 6.0% for comparable Foodworks stores in financial year 2006.⁶¹ This compares favourably with Australian retail sales growth of 4.3%.⁶² Coles experienced 1.7% store growth and Woolworths closer to 4.5% growth in supermarket stores over the same period.⁶³ Metcash, the major supplier for these SMEs highlighted in their most recent Annual Report that this strong growth in independent retailers was underpinned by a strong eastern seaboard television campaign and local store area marketing.



⁵⁷ Private sector businesses account for 99.6% of the total number of businesses in Australia and employed an estimated 7.3 million people or 85% of the total workforce in 2001. Non-agricultural private sector businesses represent 91% of the total private sector business and employed 95% of the total private sector workforce. ABS Cat. 1321.0, *Small Business in Australia*, 2001.

⁵⁸ ABS, *Small Businesses 2000*.

⁵⁹ Metcash Annual Report 2006, p. 6.

⁶⁰ Metcash Annual Report 2006, p. 7.

⁶¹ Metcash Annual Report 2006, p. 7.

⁶² ABS, Cat. 850104.

⁶³ Coles and Woolworths Annual Reports 2006, 2005.

3.1.3 Employment Contribution

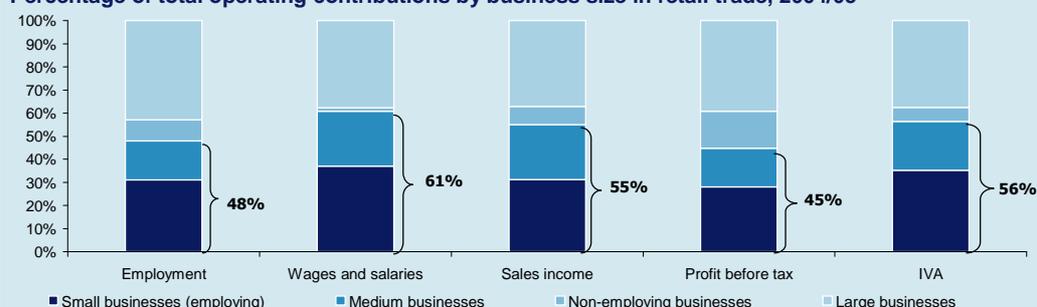
It is estimated by the ABS that non-agricultural small businesses employed almost 3.3 million people in 2000/01, which represents 47% of total non-agricultural private sector employment.⁶⁴ Once again, this demonstrates the strong economic contribution of small businesses to the Australian economy.

ABS estimates suggest that the contribution of grocery SMEs is approximately 226,400 employees (including part-time and casual employees) and 144,267 FTEs,⁶⁵ or close to 57% of total supermarket and grocery employment.

Box 4: Contribution to retail trade by business size

The graph below shows the proportion of employment, total wages paid, sales generated, etc. in the retail trade sector according to business size. The percentages in bold indicate the percentage contribution of SMEs (excluding non-employing business) to each variable of interest.

Percentage of total operating contributions by business size in retail trade, 2004/05



Source: ABS Cat. 81550

Large businesses (ie MGRs) account for a sizable contribution to the retail industry, however, cumulatively, SMEs account for a proportionately greater value given their lower market share.

Employing SMEs contribute a greater proportion of wages and salaries and Industry Value-Added (IVA) than the level of employment or profits they generate. This is indicative of the important role that SMEs play in promoting wealth redistribution and local economic prosperity through recirculation of a larger proportion of sales income at a local level.

This graph also provides a number of insights into the contribution of SMEs (excluding non-employing businesses):

- SMEs employ approximately 48% of all employees and pay approximately 61% of all wages and salaries paid in the retail trade sector, whilst large businesses employ approximately 43% of all employees and pay an even smaller proportion, 38%, of all wages and salaries paid in the retail trade sector
- SMEs generate 45% of retail trade sector profits before tax, only slightly larger than the proportion of sector profits generated by large businesses (39%). This highlights that a greater proportion of sales generated each period are distributed by SMEs in the form of wages, salaries and to local service-providers (eg accountants, lawyers, printers, local papers, etc) than by large businesses. However, large businesses distribute higher profits to shareholders than SMEs deliver to owners for reinvestment
- SMEs generate 55% of sales and 56% of the IVA of the retail trade industry – greater proportions than their employment contribution

⁶⁴ ABS Cat. 1321.0, *Small Business in Australia*, 2001.

⁶⁵ According to ABS Cat. 81550 in 2004-05 approximately 57% of all employment in the retail trade sector was through small and medium-sized businesses (including non-employing businesses). Hence, 57% of total supermarket and grocery employees (397,198 as mentioned previously) constitutes approximately 226,400 employees. Even where non-employing businesses (9% of employees) are excluded, small and medium-sized businesses still employ approximately 48% of employees.

4 Grocery retailing in Western Australia

Retailing plays an important role in the Western Australian economy, accounting for around 20% of WA's GSP and supermarket and grocery trade accounting for 74% of food retailing. Retailing has gained from WA's strong economic growth, significantly outperforming national retail performance.

WA has exhibited strong economic performance in recent years, with the state's domestic economy expanding at an eight-year high of 10.4% in 2005/06. As a result, obtaining a greater understanding of the contribution of SMEs to this rapid growth is of particular national interest. WA has had by far the highest rate of growth of all the Australian states and territories with business investment activity growing by almost 40% during 2005/06 and with domestic growth more than 2½ times the rate of growth recorded nationally.

Despite a slower growth trajectory in the domestic economy predicted for the coming years, the Chamber of Commerce and Industry of WA expects the WA economy to grow by 6.5% in 2006/07 and a further 4.75% in 2007/08. This bullish outlook is underpinned by an anticipated strengthening in export volumes.

WA's Gross State Product (GSP) reached approximately \$108 billion as of June 2006. This constitutes approximately 12% of Australia's GDP which is slightly greater than WA's 10% share of the Australian population.

The retail market has experienced very strong positive momentum from this economic strength. Figure 4.1 demonstrates that the WA retail market has significantly outperformed the national retail market since 2004. When compared over a ten-year period, the WA retail market also outperforms the national market. Figure 4.1 also highlights that retail trade in WA has consistently grown as a proportion of nationwide retail trade, growing from approximately 9.8% at the end of 2003, to approximately 10.9% as at January 2007.

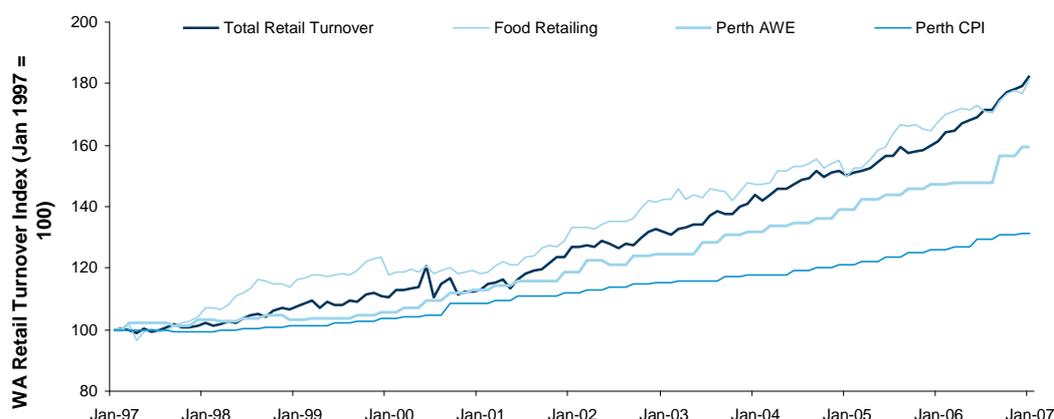
Figure 4.1: Retail turnover nationwide and in Western Australia



Source: ABS Cat. 850104

Figure 4.2 demonstrates that food retailing has grown consistently in line with retail trade, despite expectations that grocery good retailing, which represents the provision of basic staples, is not as exposed to the upside of economic turnover. This disputes the theory that food falls as a proportion of expenditure as income rises, and may suggest that people are increasingly buying more expensive food and grocery goods.

Figure 4.2: Food retailing compared with total retail turnover in WA



Source: ABS Cat. 8501010, 63020012e & 640109

4.1 Characteristics of the retail & grocery sector

4.1.1 Retail Turnover

Retail trade in WA constituted approximately 11% of total retail turnover in Australia (as at January 2007),⁶⁶ approximately equal to their contribution to the Australian population (10%).⁶⁷

Total retail turnover represented approximately 20% of WA's GSP in financial year 2006, approximately equal to the 23% that retail trade represents at a nationwide level.⁶⁸

Food retailing represents 41% of total retail trade, which is approximately equivalent to the national average. However, supermarket and grocery trade accounts for approximately 74% of total food retailing, a greater proportion than the national average of 71%.⁶⁹ Consequently, supermarket and grocery retailing for the year to January 2007 accounted for approximately \$6.98 billion in turnover.⁷⁰

⁶⁶ ABS, Cat. 850104.

⁶⁷ Ibid, ABS Cat. 31014.

⁶⁸ ABS, Cat. 850104.

⁶⁹ ABS, CPI 15th Series Weighting Pattern 6430.0. Australian average based on all eight capital cities, WA based on Perth CPI weighting.

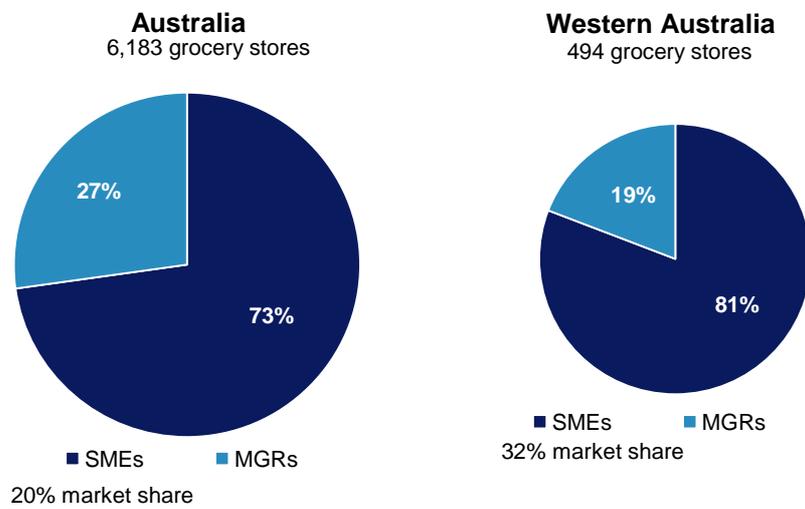
⁷⁰ ABS, Cat. 850104. Calculated as total retail sales multiplied by 41% (food retailing proportion), then multiplied by 74% (supermarket and grocery proportion). These estimates have been sourced in previous footnotes. This value could be as large as \$8.14 billion (were it to be calculated on the basis of 11% of \$74 billion, not the reported ABS figure of \$63 billion)

4.1.2 Retailer Numbers

In WA, approximately 94.7% of all retail trade businesses were classified as small enterprises in 1999/2000.⁷¹ Whilst this value is lower than the national average of 96.8%, the high representation of SMEs in terms of store numbers is reflected in independent retailers holding a higher market share in WA than any other Australian State or Territory. SMEs have approximately 32% of market share in WA.⁷²

According to IBISWorld, approximately 8% of all retail grocery stores are located in WA, or the equivalent of approximately 494 stores.⁷³ According to Metcash in WA, SMEs constitute around 400 of these stores, thereby accounting for approximately 81% of grocery stores in WA, a significantly higher proportion than the national average of 73%. The proportion of total store numbers represented by SMEs is seen in Figure 4.3.

Figure 4.3: SMEs as a proportion of total retailer numbers in Australia and WA



⁷¹ ABS, *Small Businesses 2000*.

⁷² AC Nielsen *Grocery Report 2006*, p.12.

⁷³ Based on the assumption of 4,500 independent grocery retailing stores established by NARGA and 1,683 MGR stores (as calculated from IBISWorld Reports, Coles Annual Report and Woolworths Annual Report).

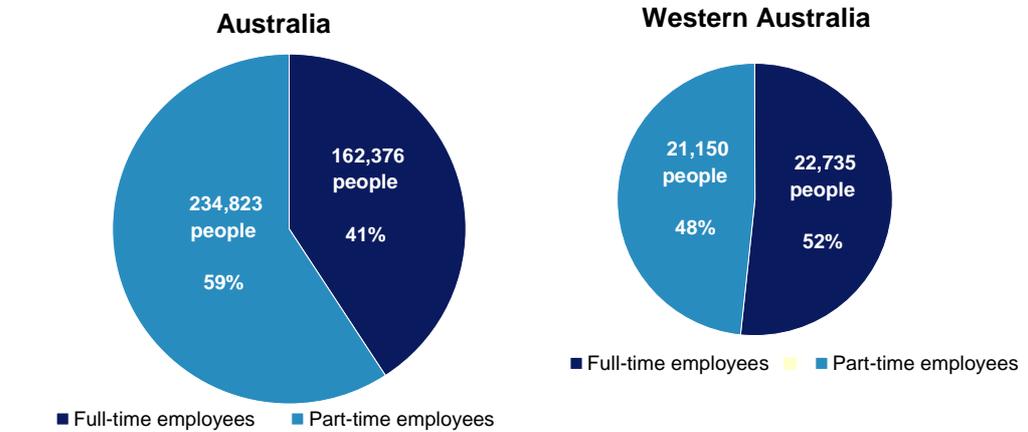
4.1.3 Employment Contribution

According to ABS statistics, a total of 156,733 employees are employed in the retail trade industry in WA, representing approximately 10% of total retail trade employment across Australia.⁷⁴

Of this value, approximately 43,885 employees and 33,310 FTEs⁷⁵ are employed in the supermarket and grocery retailing industry in WA.⁷⁶ The supermarket and grocery industry employs approximately 28% of total retail employees in WA, a greater proportion than the national average of approximately 26.5%.

The breakdown of the total grocery employment figure in WA in terms of full-time and part-time employees is shown below in Figure 4.4. WA employs 52% of employees on a full-time basis, which is higher than the national average where approximately 41% of employees in the retail trade industry are employed on a full-time basis.

Figure 4.4: Breakdown of supermarket and grocery retail employment in Australia and WA



Source: ABS Cat. 6291005 & 81550

⁷⁴ ABS, Cat. 6291005.

⁷⁵ According to ABS estimation techniques, FTEs are calculated as full-time employees plus 50% of part-time employees.

⁷⁶ According to ABS Cat. 81550, "Food Retailing" represented approximately 40% of "Retail Trade" employment. Assuming that 70% of food retailing employment is within the supermarket and grocery industry (according to retail turnover), this estimate highlights that supermarket and grocery retailing constitutes 28% of total retail trade employment.

Box 5: The deregulation debate for trading hours

Although deregulation of trading hours in WA was rejected in a referendum 2005, debate continues over the merits of deregulation to align the retail industry in WA with most other Australian states. Small businesses assert that the lengthening of operating hours will simply serve to extend the lead in market share of the major retailers, despite the fact the deregulation would almost certainly offer benefits to consumers who prefer flexibility in their shopping hours.

The *Report of the 2006/07 Review of Shop Trading Hours Act 1977* conducted by Alan Moss specifically stated that “every time shopping hours are extended the big retailers inevitably increase their sales. The overall market is not expanding rapidly enough to absorb this and hence the big retailers increase their market share at the expense of the smaller ones.”⁷⁷ Whilst a decline in small business is a transfer of wealth rather than a specific economic cost, the reduction in the variety of products and types of retailers could potentially reduce consumer and social welfare.

IBISWorld supports this, indicating that increased trading hours are generally to the detriment of smaller industry operators who lack the staff and resources to operate extended hours. It appears that culturally, shopping out of normal operating hours is more likely to be in a shopping mall rather than a suburban strip centre.

A study conducted by the South Australian Centre for Economic Studies in September 2006, which investigated the *Potential Economic Impact of Liberalisation of Shop Trading Hours*, concluded that “based on the experience of previous extensions of shopping hours, there is no evidence to suggest that further liberalisation would increase either state income or employment levels, but nor is there any evidence it would have a negative effect on the number of small retail business (in aggregate)”.⁷⁸

The study found that ABS data on retail turnover showed no evidence of a benefit or increase in retail turnover and employment as a result the reforms. The study went on to argue that the lack of acceleration in retail sales growth suggested the only change had been in the timing of retail sales.⁷⁹

The graph below, sourced from ABS data, demonstrates that despite regulated retail trading hours, retail turnover in Western Australia has been stronger than the national average and stronger than South Australia, despite SA having liberalised trading hours in 2003.

Total Seasonally-adjusted Retail Turnover by State



Source: ABS, Cat. 850104

However, the study did suggest that consumers would benefit from greater flexibility and would obtain value from being able to shop outside of existing operating hours. The increase in shop trading hours provides consumers with greater choice in the timing of their shopping and is another form of competition between industry players.

The outcomes of these studies suggest that retail hours are not a significant constraint to total sales, but rather change the timing and distribution of retail sales.

⁷⁷ Moss, A. 2007, Report of the 2006/07 Review of the Shop Trading Hours Act 1977, February 2007, p. 29.

⁷⁸ O'Neil, M., Kosturjak, A. & Whetton, S. (The SA Centre for Economic Studies), 2006, *Potential Economic Impact of Liberalisation of Shop Trading Hours*, September 2006, p. (ii).

⁷⁹ O'Neil, M., Kosturjak, A. & Whetton, S. (The SA Centre for Economic Studies), 2006, op. cit., p. 2.

5 Economic contribution of SMEs in WA

Independent retailers play a vital role in the WA grocery retailing industry, accounting for a greater proportion of turnover and stores than in any other Australian State or Territory. Independent grocery retailers are also increasingly generating significant social and environmental benefits for local communities and states as a whole.

The business value of grocery SMEs in WA is estimated to be approximately equal to \$646 million (as shown below in Figure 5.1). This value highlights the significant amount of wealth invested in the WA economy (and local economies within the State) by local independent grocery retailers and entrepreneurs in the industry.

Figure 5.1: Estimation of business value of SMEs in WA

	(A\$ million)
Metcash Turnover (WA) ⁸⁰	\$ 1,200
Retail Sales (1.75x Turnover) ^{Error! Bookmark not defined.}	2,100
EBITDA Margin (5%) ⁸¹	105
Business Value 5x EBITDA + 3x Ave Weekly Sales (inventory) ⁸²	\$ 646

Source: NARGA, Metcash, Woolworths & Coles Annual Reports 2006

Comparative business value figures can provide an indication of the growth in wealth that is reinvested in communities on a per business basis. For example, the business value of SMEs in WA suggests that each independent retailer has an average value approximately equal to \$1.615 million and will reinvest most earnings in the local community.⁸³ MGRs are comparatively less likely to be reinvest earnings at a local community level and they typically distribute over 60% of earnings as dividends to institutional and retail shareholders who are largely on the eastern seaboard of Australia.

5.1 Characteristics of the retail & grocery sector

5.1.1 Retail Turnover

Retail grocery sales among independent retailers in WA are estimated to be close to \$2.1 billion per annum,⁸⁴ all of which are supplied by Metcash who has grocery-related sales in WA of approximately \$1.2 billion per annum.⁸⁵

The *ACNielsen Grocery Report 2006* illustrates that WA, of all the Australian States and Territories, has the highest proportion of each supermarket dollar spent at independent retailers. For example, independent retailers as at September 2006 had 31.9% market share of packaged grocery trade in WA, compared with market share

⁸⁰ Metcash turnover sourced from Metcash *Market Briefing*, 6 March 2006.

⁸¹ EBITDA Margin (5%) constitutes a value approximately mid-way between the Metcash EBITDA Margin (3.5%) and Woolworths EBITDA Margin (6.5%).

⁸² EBITDA Multiple (5x) considered to be fair value.

⁸³ Based on the assumption of 400 independent grocery stores existing in WA.

⁸⁴ Assuming a 75% mark-up. This is also consistent with estimates calculated based on the market share that independent retailers hold in WA. That is, approximately 32% of total supermarket sales in 2005/06 of \$6.565 billion dollars, according to ABS Cat. 850104, equates to approximately \$2.1 billion in sales.

⁸⁵ Metcash, "FAL+100 Days" *Market Briefing*, 6 March 2006, see slide 14.

closer to 20% at a national level.⁸⁶ Although these figures do not include housebrand spending, they demonstrate that SMEs play a greater role in grocery retail trade in WA than elsewhere nationally.

However, it is estimated by NARGA that the market share of SMEs in WA was as high as 56% two decades ago. ACNielsen data supports the notion that the market share of independent retailers is shrinking in WA as well, indicating that the market share of SMEs in WA may have been closer to 40% even just 15 years ago.⁸⁷

5.1.2 Retailer Numbers & Geographic Distribution

Independent retailers are strongly represented in WA. Rates of growth in WA businesses in general, as well as specifically in small businesses in the retail industry, have consistently been higher than national averages, as shown in Figure 5.2.

Figure 5.2: Comparison of growth rates of the number of businesses in total and in retail trade in Australia and WA

Growth rates from 1983-84 to 1999-00	Australia	WA
Growth in total business enterprises	3.5%	4.6%
Growth in total small business enterprises	3.5%	4.6%
Growth in retail business enterprises	0.7%	1.5%
Growth in retail small business enterprises	0.6%	1.3%

Source: ABS, *Small Business 2000*

It is estimated that around 72% of WA's population is resident in its capital city, Perth.⁸⁸ Whilst this level of concentration is similar to Victoria and South Australia, it is significantly higher than the national average. The national average indicates that approximately 63% of the Australian population lives in capital cities.⁸⁹

WA is host to approximately 206 IGAs and 194 other independent retailers, all of which are supplied by Metcash. Although it is believed that other SMEs do operate in WA, their small size and geographic isolation would indicate that they do not constitute any material proportion of the total independent retailer numbers and are likely to be supplied by other larger IGA stores.

These 400 independent grocers service both metropolitan areas as well as the geographically harder territory in WA with thinner populations. Hence, SMEs are distributed across the state to a greater extent than the MGRs and provide rural and regional inhabitants with access to basic grocery needs.

⁸⁶ ACNielsen *Grocery Report 2006*, p. 12.

⁸⁷ Ibid.

⁸⁸ 2001 Census QuickStats.

⁸⁹ ABS Cat. 31014 and 2001 Census QuickStats. The national average was calculated on a weighted average basis (ie weighted according to population).

Box 6: Small helping small

Smaller local producers and manufacturers struggle to match MGR purchasing power

MGRs generally engage in centralised buying to effectively utilise their purchasing power and achieve economies of scale. However, this centralised procurement technique and the fact that MGRs have strong purchasing power and require larger quantities to be supplied is viewed as a threat to local primary producers, manufacturers and suppliers in WA. Hence, where smaller growers are unable to service the large volumes demanded, they risk financial difficulties through being excluded from the supply-chain of the MGRs who often require significant ranging fees and present barriers to entry for small producers and manufacturers.

In addition, with the rise in private labels many smaller producers are being contracted to supply for housebrand products, which further reduces their margins. For example, a report produced by the Economics and Industry Standing Committee in 2003, entitled *The Sustainability of the Dairy Industry in Western Australia*, stated that the “national tendering process for generic milk contracts initiated by Woolworths in 2000 continues to reduce the profitability of milk processors and dairy farmers throughout Australia”.⁹⁰

Establishment of alliances between small local growers and SMEs to sustain local industries

There is the potential for local growers and manufacturers to ensure their continuing survival and growth by marketing to independent retailers and establishing alliances to provide smaller volumes to SMEs. It was highlighted in the 2003 report that “[t]he Western Australian industry must retain a critical mass of efficient dairy farmers so that its small production base is not further diminished”.⁹¹

Therefore, independent retailers need to be able and willing to work with primary producers and intermediaries to support local WA growers and farmers. This is especially relevant to those operating in struggling industries such as the dairy industry, where farm numbers have almost halved since 2000, WA is experiencing severe milk shortages and WA farmers are the nation’s lowest paid dairy producers.⁹²



The flexibility that independent retailers can offer their suppliers by not requiring ranging allowances or promotional discounts has allowed SMEs to sustain and strengthen primary producing industries in WA. For example, in 1998 the banana industry in WA was in decline with annual sales of approximately \$2-3 million, with many plantations being removed and replaced by grapes. The Sweeter Banana Co. in WA at the time was not supported by any of the MGRs in WA and began promoting the traditionally smaller “lunchbox banana” through independent retailers.

Today, new plantations are being planted due in no small part to the success of the alliance with independent retailers and the Sweeter Banana Co. has around \$16 million in sales per annum, of which over 90% of sales are through IGA business.

Similarly, WA citrus was experiencing steady sales decline during a similar period with the industry suffering as the MGRs would not support local producers with buying programs established in the east and Riverland in SA to supply WA. To counteract this trend the “Blue Sticker” campaign was launched to identify and promote WA citrus through independent retailers. The “Buy WA” citrus campaign resulted in the resurgence of demand for local citrus and led to the development of the Sandgroper Brand for the marketing of WA citrus. In 1998, total sales of citrus excluding export were approximately \$4 million. Today, sales exceed \$8.5 million with the over 80% of business through independent supermarkets.

In future, SMEs may play an even greater role in contributing to the viability of many smaller primary producers. SMEs generally require smaller quantities and whilst their bargaining power is gaining strength through banner groups and their alliance with Metcash, they have the opportunity to procure their products independently of Metcash. This arrangement increases the potential for the benefits of increasing retail prices to be shared by retailers and producers.

⁹⁰ Economics and Industry Standing Committee (2003), “The Sustainability of the Dairy Industry in Western Australia”, Report No. 8 in the Thirty-Sixth Parliament, 4 December 2003, p. xxv.

⁹¹ Ibid.

⁹² Thomson, J. 2007, “Milk price ‘must rise’ to save State’s farmers”, *The West Australian*, 2 March 2007.

5.1.3 Employment Contribution

According to statistics from *Small Businesses 2000* produced by the ABS, employment growth among small businesses has generally been stronger than the average for all businesses. Employment growth in WA businesses has been consistently stronger than with national businesses, as seen in Figure 5.3. Although these figures are historical, the figures for WA are likely to be conservative in light of recent economic strength.

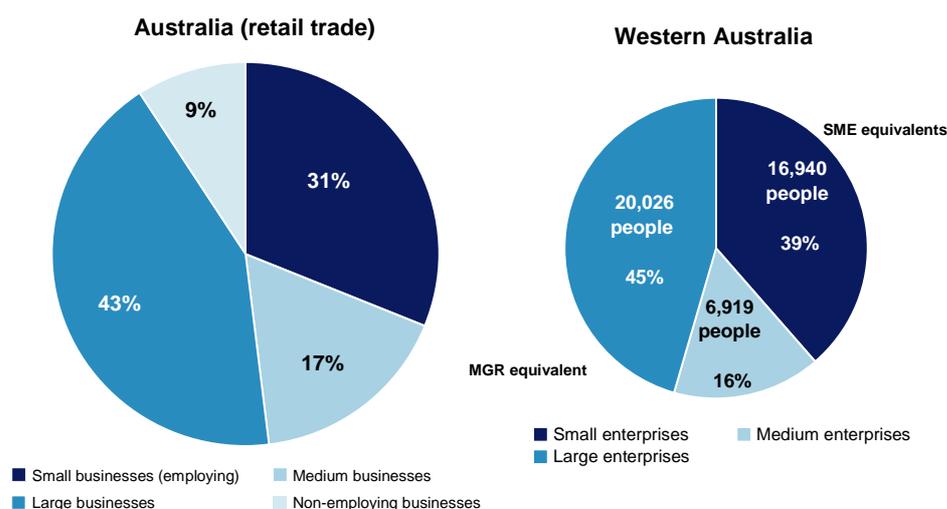
Figure 5.3: Comparison of growth rates of the number of employees in total and in retail trade in Australia and WA

Growth rates from 1983-84 to 1999-00	Australia	WA
Employment growth in all businesses	2.8%	3.8%
Employment growth in small businesses	3.1%	4.3%
Employment growth in retail businesses	NA	3.8%
Employment growth in retail small businesses	1.0%	2.8%

Source: ABS, *Small Business 2000*

SMEs employ an estimated 23,859 employees and 18,133 FTEs in WA, or approximately 54% of total grocery employment in WA, a slightly lower figure than the national average of 57%.⁹³

Figure 5.4: Employment contribution by business size

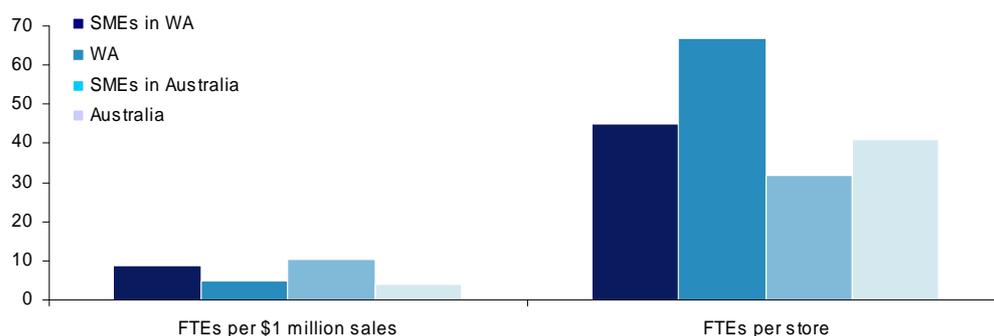


Source: ABS, *Cat. 81550 & Small Businesses 2000*

Independent retailers have significantly higher labour intensity than the average levels in WA, and Australia in general. This is represented in Figure 5.5 on the following page.

⁹³ ABS Cat. 81550 provides a breakdown of the proportion of employees employed in different sized enterprises (small, medium and large) in the retail trade industry. The above figures have been derived by extrapolating the size of small business employment in the WA grocery retail industry made from the ABS publication of *Small Businesses 2000* and combining these estimates with the proportions of employment provided in Cat. 81550 regarding the split between small and medium-sized businesses. These estimates were then compared with the WA employment figure of 43,885 FTEs derived from ABS Cat 6291005 and 81550, which matches closely with calculations derived from the *Small Businesses 2000* report.

Figure 5.5: Comparison of labour intensity in the grocery retail sector, 2005/06



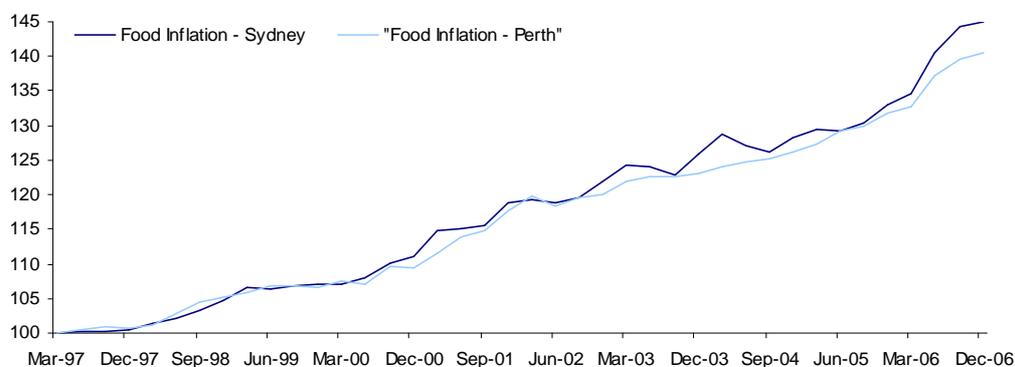
SMEs play a greater role in generating employment per \$1 sales. Calculations based on sales from 2005/06 suggest that SMEs in WA contribute almost 9 FTEs per \$1 million in grocery sales, which is slightly lower than the Australian average of just over 10 FTEs per \$1 million. However, SMEs in WA compare favourably with national figures – WA employs around 5 FTEs per \$1 million sales, and the national average is closer to around 4 FTEs per \$1 million in sales. WA’s labour intensity is greater than the national average when FTEs per store are compared.

5.2 Recent Trends

5.2.1 Food price inflation

Analysis of inflation statistics demonstrates that over a 10 year period, Sydney and Melbourne have had almost identical rises in food prices, whereas Perth has had a slightly lower rise in food prices (see Figure 5.6). Whilst there was close correlation between food price inflation in Perth and Sydney up until June 2005, since this date Sydney food price inflation has risen to be 3% greater than that in Perth. This is an interesting result given the remoteness of Perth, as a significant proportion of groceries originate from eastern states, which adds to transport costs with this period also seeing transport costs rise significantly due to higher fuel prices. These circumstances suggest that it could have been expected for Perth to have higher food price inflation than at a national level. NARGA attributes the lower prices in Perth to be substantially a result of the higher market share of the independent grocery sector. A longer time period will be required to confirm this view.

Figure 5.6: Comparison of food price inflation in Sydney and Perth



Source: ABS Cat. 640103

The difference in food price inflation between the two cities may also be related to the nature of CPI food weightings. The food category “meals out and takeaway foods” has a consistently higher weighting for Sydney than for Perth. This category generally plays a larger contributory role in driving food price inflation growth than any other food category. Sydney’s current “meals out and takeaway foods” weighting is 4.9%, compared to Perth’s 3.91%, whereas Sydney’s current overall food weighting (excluding “meals out and takeaway foods”) is 10.7% compared to Perth’s 11.07%.⁹⁴

5.3 Local economic impacts

The total economic impact of independent retailers at a local or community level in WA is believed to be particularly significant, considering their large volume (81% of total stores) and their disproportionately high employment contribution as compared to their market share (ie grocery SMEs employ 54% of total grocery industry employees in WA, although they hold only 32% market share). Independent grocery retailers promote the localised accumulation and redistribution of wealth and source a larger proportion of their inputs on a local basis.

Although the quantum of expenditure by MGRs is greater than that of SMEs on a national level, anecdotal evidence suggests that the margins and profits generated by the MGRs in WA are redistributed to shareholders, the majority of which live on the eastern seaboard where this wealth is subsequently accumulated. On the other hand, growth in profits generated by SMEs largely remains in WA to accumulate wealth in local areas.

There is also a growing body of research, particularly from the USA, that investigates total aggregate economic impacts at a local level. Initial indications suggest that locally owned or independent retailers have greater contributory effects on local economies – that is, they have higher multiplier effects or indirect impacts – than major chain retailers.

The studies highlight that independent retailers make an economic contribution at a local level (such as within local WA communities) that is two to three times greater than that of major chain retailers. The studies indicated that for every \$1 spent in an independent retailer, the local economy gained approximately an additional 40¢ in economic recirculation and redistribution benefits, whereas only around a third of this value was generated at a local level by the presence of MGRs.⁹⁵

This suggests that where independent grocery retailers lose market share in WA, local providers of goods and services as well as local producers and manufacturers may be likely to experience a downturn. As a result, if independents lose market share, it would be expected that benefits to the local economy would be lower as the local redistribution of incomes from independent grocers is reduced due to MGRs sourcing a greater proportion of their inputs from outside WA.

The phenomenon of comparative local economic impacts of SME equivalents compared to MGRs from an array of studies are summarised in Box 7.

⁹⁴ ABS Cat. 6430. Weightings given according to the 15th series CPI weighting pattern, established in September 2005.

⁹⁵ Calculated as an average of the multipliers found in the economic impact studies.

Box 7: Comparative Economic Impacts – SMEs v MGRs

There is a growing body of research from the United States which focuses on estimating the quantitative and qualitative economic impact and contribution of local independent retailers. Particular focus has been given to the role of independent retailers in the context of the growth of national chains or 'big box' retailers such as Wal-Mart.

A large number of studies found that locally owned stores generate greater benefits for local economies, both quantitatively and qualitatively, than national chains, especially in regional areas. Several researchers further make the case for community governments to create policy to protect their independent businesses.

"In a study comparing the economic impact of ten Andersonville businesses and their chain competitors, it was found that locally-owned businesses generate a substantial Local Premium in enhanced economic impact...For every \$100 in consumer spending with chain firms, \$43 will remain in the local economy; if that same spending occurs with a locally-owned firm, that value jumps by 58 per cent, to \$68. Similarly, for every square foot of space occupied by a chain, the local economic impact is \$105; if a local firm occupies that same space, impact jumps by 70 percent, to \$179."

Civic Economics, 2004, "The Andersonville Study of Retail Economics" (Chicago, Illinois)

"When residents...spend \$100 at a big box retailer, their purchase generates \$14 in local spending by the retailer. That same \$100 spent at a locally owned business generates \$45 in local spending, or three times as much. Dollars spent at a local retailer support not only that store, but a variety of local businesses.

"All eight [locally owned retailers] bank with locally owned banks. They purchase inventory from local manufacturers, and advertise in local newspapers, and hire local accountants, printers, internet service providers, and repair people.

"A typical big box store spends 14.1 percent of its revenue within the local and state economy, mostly in the form of payroll. The rest leaves the state, flowing to out-of-state suppliers or back to corporate headquarters."

Institute for Local Self-Reliance, 2003, "The Economic Impact of Locally Owned Businesses vs. Chains, A Case Study in Midcoast Maine"

"Local merchants generate substantially greater economic impact than chain retailers.

"Development of urban sites with directly competitive chain merchants will reduce the overall vigor of the local economy.

"Most changes in consumer spending habits can generate substantial local economic impact. For every \$100 in consumer spending at Borders, the total local economic impact is only \$13. The same amount spent with a local merchant yields more than three times the local economic impact. If each household in Travis county simply redirected just \$100 of planned holiday spending from chain stores to locally owned merchants, the local economic impact would reach approximately \$10 Million."

Civic Economics, 2002, "Economic Impact Analysis: A Case Study Local Merchants vs. Chain Retailers"

"In many ways, [the trend of growing national chains] poses a threat to Santa Fe and results in a large outflow of money from the local economy. The impact of dollars spent at independent businesses deliver two times the economic impact of spending at national chains...Furthermore, small and independent businesses are an important way of preserving the local heritage...Support of small businesses goes hand in hand with supporting the culture of underrepresented groups and a venue for sharing art, crafts, and agricultural goods."

Angelou Economics, 2003, "Santa Fe Independent Business Report"

"Big box retailers and superstores often can result in the reduction of consumer choice due to their tendency to cannibalize competing retail businesses...When a big retailer or superstore closes a store the huge vacancy created often results in a long term blighting condition and a significant reduction in the value of the property on which it was located as well as in the surrounding properties. It can also cause damage to local business."

Rodino Associates & Estela Lopez Consulting, 2003, "Final Report on Research for Big Box Retail / Superstore Ordinance"

"By pricing groceries as "loss leaders" and using higher margin non-grocery items to make up the difference, supercenters often force existing supermarkets out of business. Because grocery stores anchor many neighbourhood business districts and shopping centers, their closure would harm other retailers and lead to vacancies..."

Local First Vermont (<http://localfirstvermont.org/resources/document.2006-08-29.5052203224>) referring to Rodino Associates & Estela Lopez Consulting Report, 2003

5.4 Social and community benefits of SMEs

Beyond the quantitative economic impacts that SMEs provide, independent grocery retailers can generate significant social and environmental benefits for local communities and states as a whole. Whilst these benefits have often been quantified in economic terms, many of these benefits deserve to be mentioned on a qualitative basis to clearly establish the multi-functional economic impact of SMEs.

A study compiled by the Institute for Local Self-Reliance with a focus on the state of Vermont in the USA⁹⁶ provided a list of clear economic, social and environmental benefits which are summarised below and are highly relevant to the WA state economy.

5.4.1 Independent retailers contribute to community character and well-being

Community retailing and local ownership contributes to local character and cohesion, and community well-being by ensuring important business decisions are made within the community by those who will feel the impact of those decisions. SMEs play an important role in improving community engagement and in the development and maintenance of a sense of local identity, cultural events and an active community life.

In addition, SMEs typically locate on the 'high street' of towns and suburbs, and within these zones community interaction and engagement develop. This location also provides a mechanism for better connecting local communities.

5.4.2 Independent retailers assist sustainable local economic prosperity

Locally owned businesses generally reinvest a significantly larger share of revenues back into local and State economies than MGRs. In addition to keeping profits local, they often create opportunities for a variety of other local businesses and service-providers such as accountants, local papers and banks, repair and maintenance staff, and local suppliers. This is particularly evident in the fact that most of the services that supply the retail trade sector listed earlier (and expanded upon in Appendix A) are likely to be procured locally by SMEs rather than at a centralised location, as is the case for most MGRs.

The contribution to local economic prosperity that locally owned businesses also make encompasses employment of more local people in proportion to their overall revenues when compared to MGRs (whose entry into local areas is also suggested to result in the decline in existing local businesses and thereby causing a net reduction in local jobs).

Independent retailers also provide employment for the majority of supermarket and grocery employees. Independent retailers (in combination with MGRs), particularly in the retail sector, also provide many thousands of entry-level employment opportunities, and contribute to the development of transferable job skills (eg communication skills) and valuable attitudes to work and personal development among these employees.

⁹⁶ Mitchell, S. (2003), op. cit., pp. 3-10.

5.4.3 Independent retailers promote entrepreneurship

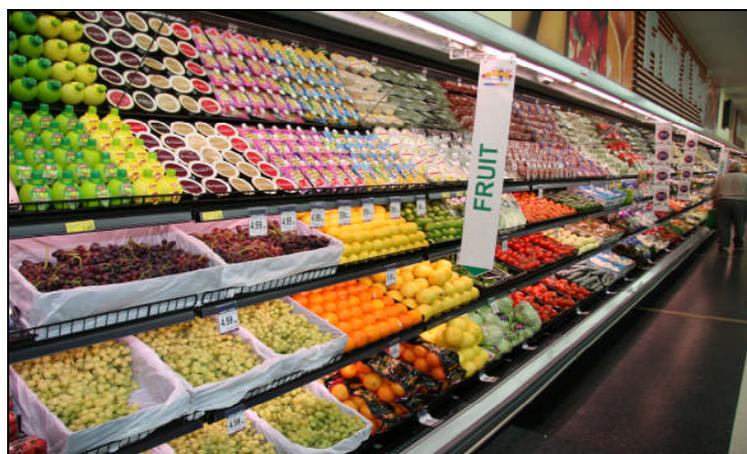
The growth in national chains is generally associated with a reduction in opportunities for entrepreneurs who face higher barriers to the grocery industry and greater competition due to oligopolistic nature of the grocery retailing market.

In addition, entrepreneurship has often been considered “an equaliser” – offering low-income, minority, immigrant and other disadvantaged socio-economic groups the opportunity to move out of low-wage jobs and engage in personal investment and economic innovation, thereby contributing to the prosperity of local economies as well.

5.4.4 Independent retailers enhance competition and consumer choice

The economic model of ‘perfect competition’ highlights that vigorous competition, low prices, and greater product diversity and quality over the long-term are generally associated with a larger number of small, independent businesses. Therefore, the strength and vitality of independent grocery retailers has a direct impact in enhancing customer focus, broadening consumer choice and providing increased competition for the MGRs, thereby requiring them to respond with superior products and services to attract consumers.

The disappearance of local retailers and the growth in MGRs, who generally source from large manufacturers, may mean that small grocery manufacturers and primary producers find it increasingly difficult to obtain shelf space and consumer choice is reduced.



5.4.5 Independent retailers provide environmental benefits and sustain local environments

Smaller locally-owned businesses help maintain vibrant and walkable town centres, thereby limiting sprawl, vehicle use and pollution. Large national chain stores generally open in large malls and choose areas of land which are cheaper and faster to develop rather than opening in an established commercial district or town centre.

The development of large car parks associated with MGRs and shopping malls in which they are located, and the store locations in general, also favour driving and discourage walking and public transport. Therefore, independent retailers help reduce traffic and parking congestion and help limit the detrimental environmental consequences associated with the development of large chain stores.

6 Conclusion

The economic contribution and participation of SMEs in the grocery industry is both significant in the Australian context, and is even more prominent in WA. SMEs play a vital role in sustaining competition, maximising consumer choice and in controlling long-term food inflation.

Australia has one of the most concentrated retail grocery industries in the world. This dominance, whilst it is expected to offer consumers lower prices due to the economies of scale and lower unit costs, is generating growing concerns over the current high level of food price inflation and over the long-term implications for competition. The adverse impact of any reductions in the level of market share of SMEs would be likely to both further reduce the bargaining power of small primary producers and endanger consumer welfare in the form of reduced choice and less price competition.

WA is an example where retail growth has been particularly strong, outperforming national growth since the mid-1990s and it continues to remain strong on the back of growth in the resources sector. SMEs have also played a more pronounced economic role in the supermarket and grocery industry, representing a greater proportion of total stores and having a level of market share that is more approximately 50% greater than independent retailers in any other Australian State and Territory.

Whilst the overall level of independent retailing across Australia has remained relatively constant, ACNielsen data shows that the long-term trend in WA has been towards a shrinking independent retailing market. Should the market share of SMEs, currently approximately 32%, reduce to the size of the national average of approximately 20%, there is the risk that the benefits that WA currently experiences from independent retailers could be potentially lost.

Where SMEs in the grocery retailing business close or are taken over by MGRs, the wealth generated from each business would be transferred, which in itself is not an economic cost. However, in the case of WA, it is most likely that this wealth would be transferred outside the State, and the local and regional benefits which the WA economy receives as a result of SMEs would be transferred to other States and Territories.

There is also the “critical mass” argument; the concern that if independent grocery sales in WA were to fall by even 20%, it may not be viable any longer to keep the WA warehouse of IGA-Distribution (IGA>D) open. This would have a significant impact on local communities in WA, the WA economy and employment levels in particular.

The greater market share of independent grocers in WA (32%) provides higher local employment and statewide economic benefits than if grocery retailing transitioned to the national average where independent grocers have a 20% market share. For example, if the market share of independent grocers in WA fell to 20% (all else held equal), this could translate into an approximately 3,800 fewer jobs in the grocery retailing sector in WA.⁹⁷

⁹⁷ This figure is calculated on the basis that if SMEs were to lose 10% market share in WA (or one-third of their market share), SME head count would reduce by a similar proportion (or 6,044 FTEs). This loss in employment would be mitigated by an increase in employment by MGRs proportionate to the 10% increase in market share (or 2,168 FTEs). Despite this, a net loss in employment of 3,876 FTEs (6,084 less 2,168) would be likely to result if the market share of independent grocery retailers reduces from approximately 30% to 20%.

Conclusion



A decrease in independent grocery market share in WA would also have detrimental impacts on businesses which support independent grocery retailers (e.g. local processors and manufacturers, accountants, printers, packaging suppliers, smaller primary producers and local storage, warehousing and wholesalers). Most of these support services would be likely to be procured interstate or centrally by MGRs. Therefore, the local businesses and employees supported by independent retailers, and the communities in which independent grocery retailers operate who gain significant social and community benefits as a result of the economic participation of SMEs, would be adversely impacted by any reduction in their market share.

However, whilst it is predicted that there are risks associated with operating in one of the most concentrated grocery retail markets in the world, there are positive outcomes to be taken from the strong participation of SMEs in the grocery retailing industry.

The rationalisation of SMEs into banner groups such as IGA and FoodWorks and their alliance with Metcash will be crucial in allowing independent retailers to strengthen their position in the market and to challenge the MGRs. The ability of SMEs to provide value-add to consumers through factors such as convenience, tailored product range and customised store layout for local needs will also be important to their ongoing economic participation and success.

PwC's 2007 publication of *Retail & Consumer Outlook Australia – Changes in play* highlights that:

“While independent retailers can feel confident that they have a bright future, they still have to plan how they will deal with the tectonic forces generated by Australia’s two grocery retailing giants.”

Therefore, it is important that policymakers are cognisant of the policy settings pertinent to the retailing industry. This will be critical to ensuring that the regulatory and compliance burden placed on retailers is not disproportionately felt by SMEs. It is also important to making certain that competition is promoted in the grocery industry and that competitors are not disadvantaged by the extending dominance of MGRs under pressure to deliver increased earnings.

It is also important that the significant beneficial economic impact of SMEs is acknowledged and appreciated. Whilst it may be a small component of the total economy and MGRs generate significantly greater volumes of sales, SMEs constitute the majority of grocery stores and make a critical contribution in their own right to servicing customers in more regional and remote areas, as well as providing greater choice for consumers. Independent retailers have an economically valuable role as a balancing competitive force against the MGRs and as enhancers of consumer choice and welfare in the grocery retailing industry.

Appendix A Intra-industry flows into retail trade

Input by Industry and Final Use Category and Supply by Product Group 1996-97		
	SUPPLY	5101
USE		Retail trade
0101 Sheep		
0102 Grains		
0103 Beef cattle		
0104 Dairy cattle		
0105 Pigs		
0106 Poultry		2.4
0107 Other agriculture		121.6
0200 Services to agric.; hunting		
0300 Forestry and logging		0.2
0400 Commercial fishing		134.2
1100 Coal; oil and gas		52.8
1301 Iron ores		
1302 Non-ferrous metal ores		
1400 Other mining		1.5
1500 Services to mining		
2101 Meat and meat products		808
2102 Dairy products		226.9
2103 Fruit and vegetable products		28.3
2104 Oils and fats		42.6
2105 Flour and cereal foods		136.1
2106 Bakery products		75.2
2107 Confectionery		50.1
2108 Other food products		97.2
2109 Soft drinks, cordials, syrups		17
2110 Beer and malt		0.5
2111 Wine and spirits		1.6
2112 Tobacco products		
2201 Textile fibres, yarns etc		7.2
2202 Textile products		83
2203 Knitting mill products		16.3
2204 Clothing		51.4
2205 Footwear		10.4
2206 Leather and leather products		1.1
2301 Sawmill products		38.8
2302 Other wood products		241.7
2303 Pulp, paper and paperboard		6.6
2304 Paper bags and products		185.7
2401 Printing; services to printing		1,413.00
2402 Publishing; recorded media etc		1,018.50
2501 Petroleum and coal products		212.6
2502 Basic chemicals		3.6
2503 Paints		5.1
2504 Pharmaceuticals etc		1.7
2505 Soap and detergents		4.6
2506 Cosmetics and toiletries		0.4
2507 Other chemical products		3.2
2508 Rubber products		68.4
2509 Plastic products		84.5
2601 Glass and glass products		9
2602 Ceramic products		3.4
2603 Cement, lime and concrete slurry		3.5
2604 Plaster; other concrete products		1.4
2605 Non-metallic min. products nec		9.6
2701 Iron and steel		6
2702 Basic non-ferrous metals etc		1.9
2703 Structural metal products		0.6
2704 Sheet metal products		147.8
2705 Fabricated metal products		117.9
2801 Motor vehicles and parts etc		371.7

Intra-industry flows into retail trade

Input by Industry and Final Use Category and Supply by Product Group 1996-97	
	SUPPLY
USE	5101 Retail trade
2802 Ships and boats	
2803 Railway equipment	
2804 Aircraft	0.1
2805 Scientific etc equipment	4.5
2806 Electronic equipment	2.7
2807 Household appliances	69.5
2808 Other electrical equipment	64.6
2809 Agricultural, mining etc machinery	4.6
2810 Other machinery and equipment	13.4
2901 Prefabricated buildings	0.2
2902 Furniture	7.1
2903 Other manufacturing	92.4
3601 Electricity	350.9
3602 Gas	28.6
3701 Water, sewerage and drainage	14.6
4101 Residential building	
4102 Other construction	2.3
4501 Wholesale trade	688
5101 Retail trade	106.7
5401 Mechanical repairs	386.9
5402 Other repairs	1,327.00
5701 Accommodation, cafes & restaurants	505.1
6101 Road transport	187.8
6201 Rail, pipeline, other transport	57.5
6301 Water transport	15.3
6401 Air and space transport	294
6601 Services to transport; storage	421.3
7101 Communication services	2,242.50
7301 Banking	746.8
7302 Non-bank finance	207
7401 Insurance	332.3
7501 Services to finance etc	35.6
7701 Ownership of dwellings	
7702 Other property services	2,012.40
7801 Scientific research etc	349
7802 Legal, accounting etc services	4,057.10
7803 Other business services	1,837.70
8101 Government administration	177.6
8201 Defence	
8401 Education	55.6
8601 Health services	14
8701 Community services	
9101 Motion picture, radio etc	508.2
9201 Libraries, museums, arts	31
9301 Sport, gambling etc	6.5
9501 Personal services	75.7
9601 Other services	46.5
T1 Total Intermediate Uses	23,307.50
P1 Compensation of employees	17,944.70
P2 Gross operating surplus & mixed income	2,305.50
P3 Taxes less subsidies on products	1,046.40
P4 Other taxes less subsidies on production	1,059.90
P5 Complementary imports	
T2 Australian Production	45,664.00
P6 Competing imports	196.8
T3 Total uses	45,860.80
V1 Gross value added (P1 + P2 + P4)	21,310.10

Source: ABS, Cat. 52090 (Input-Output Tables 1996-97)