Affidavit

IN THE FAIR WORK COMMISSION
PENALTY RATES

Matter No: AM 2014/305

I, **Kevin Patrick Kirchner**, of **16 Kalina Avenue, Para Vista, South Australia** do **SOLEMNLY AND SINCERELY DECLARE AND AFFIRM** as follows:

1. I make this affidavit based on my own knowledge, information and belief unless otherwise stated.

2. I have been informed by the solicitors for the Shop, Distributive and Allied Employees' Association that certain employer organisations may seek to make the following submissions in this proceeding:

   The retail industry is not strong or at a very healthy level, but in fact has struggled. This is particularly the case in recent times (i.e., since 2012), as a result of a slowdown in retail prices, decline in operating profitability, increased rate of closures (exits), and lower aggregate retail hours worked.

   Further, that it is an overstatement to describe the retail industry as being healthy, if not verging on strong.

3. I have considered these submissions and for the reasons set out in my report entitled *A Critique of the Report entitled "Retail Award Research", being a Report prepared for the Fair Work Commission by ACRS, Monash Business School, Monash University* dated 17 August 2015 (**Kirchner Report**), disagree with both of them.

   Annexed and marked **KPK-1** is a true copy of the Kirchner Report.

4. My opinion remains as expressed in the Executive Summary and Conclusion on pages 11 and 48 respectively of the Kirchner Report that:

   Overall, the conclusion of the analysis undertaken for this report is that there is little to no evidence to suggest that the retail industry at the current time can properly be described as "continuing to struggle". To the contrary, the overall situation of the Australian retail industry is better described as being 'healthy', if not actually verging on being "strong". Certainly, real retail sales growth of 3.3%, as occurred across 2014/15, back[ed] up by total profits across the industry remaining around record levels, together with retail profit margins remaining near their highest level of the past 15 years, indicates to my mind at least that the Australian retail industry is in a very healthy state.

AFFIRMED by the deponent)

At Melbourne on the 4th day of November 2015)

Before me:

Malcolm Hardwig
Australian Lawyer.
550 Lonsdale St
melbourne.

IN THE FAIR WORK COMMISSION
PENALTY RATES

Matter No: AM 2014/305

This is the annexure marked " **KPK-1** " referred to in the affidavit of Kevin Patrick Kirchner Affirmed this 4th day of November 2015 before me.

.....

Before me:
An Australian Lawyer.
550 Lonsdale St
Melbourne.

KPK-1

FULCRUM ECONOMICS AUSTRALIA

A Critique of the Report entitled "Retail Award Research", being a Report prepared for the Fair Work Commission by ACRS, Monash Business School, Monash University (as provided to the FWC June 2015)

This Critique is Prepared for the Fair Work Commission as input to the 2015 Review of the General Retail Industry Award 2010

Prepared Under Instructions from the Shop Distributors and Allied Employees' Association (SDA),

The author of this report, Mr Kevin Kirchner, is scheduled to appear before the Fair Work Commission as an expert witness.

(August 2015)

Fulcrum Economics Australia

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Para Vista, South Australia

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ph. 0410 347 615 (mob.)

Declaration

In preparing this report I believe that, to the best of my knowledge, I have made all the appropriate inquiries and considered all of the appropriate data and evidence required to be able to properly, objectively and expertly address the issues which are the focus of this report. Furthermore, also to the best of my knowledge, in preparing this report I believe that I have not omitted or withheld from them Commission any matter of significance or evidence that I regard as relevant to the issues addressed in this report.

Kevin Kirchner

Principal

Fulcrum Economics Australia

17th August 2015

Focus and Purpose of this Report

The author of this report, Mr Kevin Kirchner, Principal, Fulcrum Economics Australia, was engaged by the Shop Distributors and Allied Employees' Association (SDA) to undertake a critique of the report entitled "Retail Award Research", being a report prepared for the Fair Work Commission by Dr. Sean Sands of the ACRS, Monash Business School, Monash University; and to offer expert opinion in relation to the findings of that report.

The specific instructions provided by the SDA to Mr Kirchner were as follows:

> "Please provide a written report containing your opinion of Part One of the Sands Report.
>
> In providing your opinion, please direct your attention to:
>
> (a) the statement in the Executive Summary of the Sands Report that "*the slowdown in retail sales in real prices, decline in retail firm operating profitability, increase in retail business closures and aggregate retail hours worked not recovering to 2007 peak, indicates that despite some improvement since 2012, the retail industry continues to struggle*"; and
>
> (b) the nature and extent of any changes in economic conditions in the retail industry between 2010 and 2014."

The "Retail Award Research" report (aka the Sands report) was provided to the FWC in June 2015.

The CV of Mr Kevin Kirchner is attached as Appendix A to this report.

A copy of the letter of engagement is attached at Appendix B to this report.

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Executive Summary

The purpose of this report was to provide a critique of Part One of the report by Dr Sands of the ACRS, Monash University, entitled "Retail Award Research" (referred to in this report as 'the Sands Report'), which had been prepared as input into the Fair Work Commission's 2015 review of the General Retail Industry Award 2010.

Part One of the Sands report attempts to provide an assessment of the current state of the retail industry. It does so very badly. The conclusions of the report are based on several serious misinterpretations of the data, as well as incorrect usage of data, which leads Dr Sands to reach conclusions which, to put it bluntly, are wrong.

I do not consider this to be a matter of opinion. Quite simply, the majority of Dr Sands' conclusions (or, in some cases, conjectures) are wrong. The evidence to support this conclusion is provided in this report.

The nearest Dr Sands comes to an overall conclusion of his analysis at Part One of his report is the following sentence from his Executive Summary:

"The slowdown in retail sales in real prices, decline in retail firm operating profitability, increase in retail business closures and aggregate retail hours worked not recovering to 2007 peak, indicates that despite some improvement since 2012, the retail industry continues to struggle"

However, I contend that such a conclusion is not supported by the facts. In short, it is wrong to describe the Australian the retail industry as currently being in a situation where it '... continues to struggle'. To the contrary, the vast majority of the evidence points to the Australian retail industry currently being in a state which at the very least can be described as 'healthy', if not actually strong.

The reality is that Dr Sands' report exhibits a lack of expertise in the area of economic analysis, is error-ridden in its analysis and data interpretation, and lacks a proper degree of comprehensiveness.

Contrary to the findings of Dr Sands, the analysis presented in this report shows that:

- ***retail sales*** *have* continued to grow in real terms over the period 2010 to 2014/15 and have done so in a fairly *solid* manner *(refer Figure ES1 and Table ES1);*
  - furthermore, the rate of growth of retail sales has improved since 2012/13, being up 3.1% in real terms in 2013/14 and a further 3.3% in 2014/15 sales, which equates to very solid growth.

- total ***profits*** across the retail industry as a whole have remained at a strong *level* over recent years, notwithstanding that the *rate of growth* in total profits has been relatively slow across this period (eg compared to the period 2001 to 2008) *(refer Figures ES2 and ES3)*
  - to put it in perspective it can be noted that by 2012/13 total profits for the retail sector as a whole had moved back above the record level reached at the end of the 'boom period' (ie around 2008) following almost 15 years of sustained strong growth of the Australian economy, and have remained above this level since then.
- ***profit margins*** for the retail industry have remained at strong levels in the period 2010 to now, around historical highs *(refer Figure ES4)*
- the ***total wages bill*** of the retail industry has grown at a slightly higher rate than the growth in sales in the period since 2010, but not to the extent of damaging profitability
  - the main explanation for this is that there has continued to be strong growth in labour productivity in the retail trade industry in this period *(refer Figure ES5)*
- the number of ***persons employed*** in the retail industry has continued to climb in recent years, with the number of persons employed on average across the year ended May 2015 up 3.6 per cent on the number of persons employed on average across the year ended May 2010
  - admittedly this is not a strong rate of growth of employment, but nor is it negative growth.
  - it is also important to recognise that employment growth is not necessarily the best indicator of the health of an industry. Profitability and business survival rates are better indicators.
- ***online retail purchases*** from non-Australian-resident retailers remain a very small proportion of total 'general retail' sales, perhaps as little as 1.1%. As such, it cannot be claimed that growth in these sales has had a significant negative impact on the local retailing industry.
- the high level of ***'exits'*** from the retail industry in recent years is not a matter of major concern. It does not point to a sharp drop in the health or viability of the Australian retail industry. This is because:
  - i) not all "exits" represent business failures
  - ii) the data has been significantly skewed by changes in definitions in the ABS's data collection for this series, so that the number of 'exits' have been significantly skewed upwards in recent years; and

iii) the nature of the retail industry is such that there will *always* be a high level of entries and exits *no matter what the overall state of the economy or of business operating conditions*.

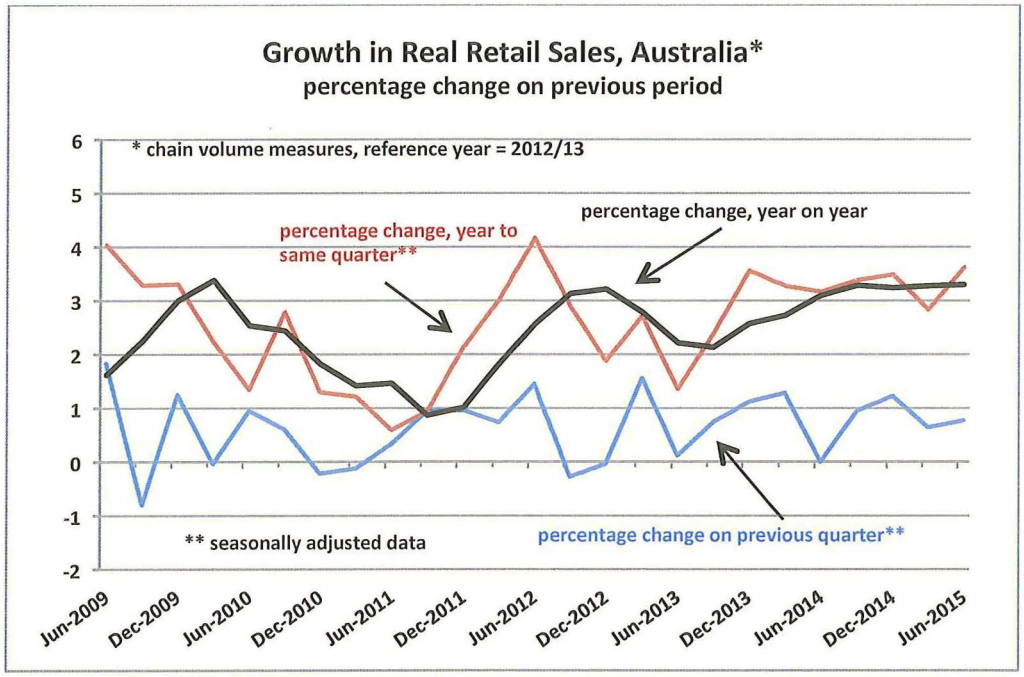
One area of concern identified by Dr Sands – and confirmed by the analysis undertaken for this report – is the continued decline in the number of young people employed in the Australian retail industry. The number of persons aged 15 to 19 years employed in the retail industry has continued to decline over recent years, even as the number of persons in other age groups employed in the retail industry has picked up (refer Figure ES6).

The reason for this trend is unclear and to my mind is a matter warranting further research.

It seems to me, however, that the continued decline in employment of persons aged 15 to 19 years cannot be taken as an indicator that the retail industry "...continues to struggle"; not when employment among other age groups has increased.

Overall, the conclusion of the analysis undertaken for this report is that there is little to no evidence to suggest that the retail industry at the current time can properly be described as "continuing to struggle". To the contrary, the overall situation of the Australian retail industry is better described as being 'healthy', if not actually verging on being "strong". Certainly, real retail sales growth of 3.3%, as occurred across 2014/15, back up by total profits across the industry remaining around record levels, together with retail profit margins remaining near their highest level of the past 15 years, indicates to my mind at least that the Australian retail industry is in a very healthy state.

Figure ES1



Source: ABS cat. no. 8501 *Retail Trade*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Table ES1

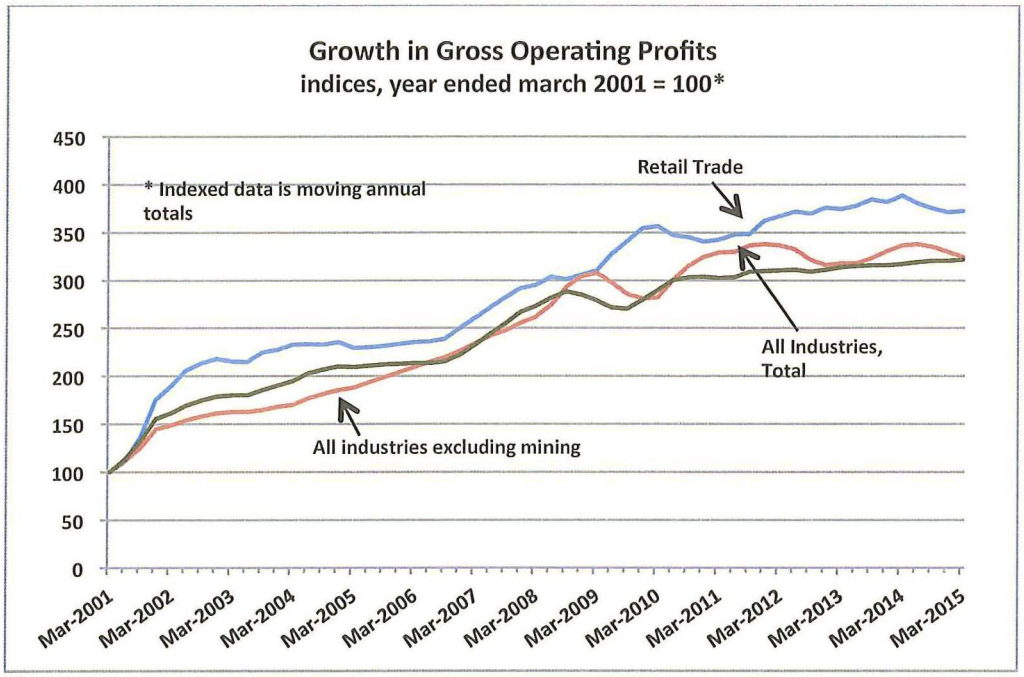
Growth in Real Retail Sales and in Real GDP

(percentage change, year on year)

	Retail Sales	GDP
2009/10	2.5	2.0
2010/11	1.5	2.3
2011/12	2.6	3.7
2012/13	2.2	2.5
2013/14	3.1	2.5
2014/15	3.3	n.a.

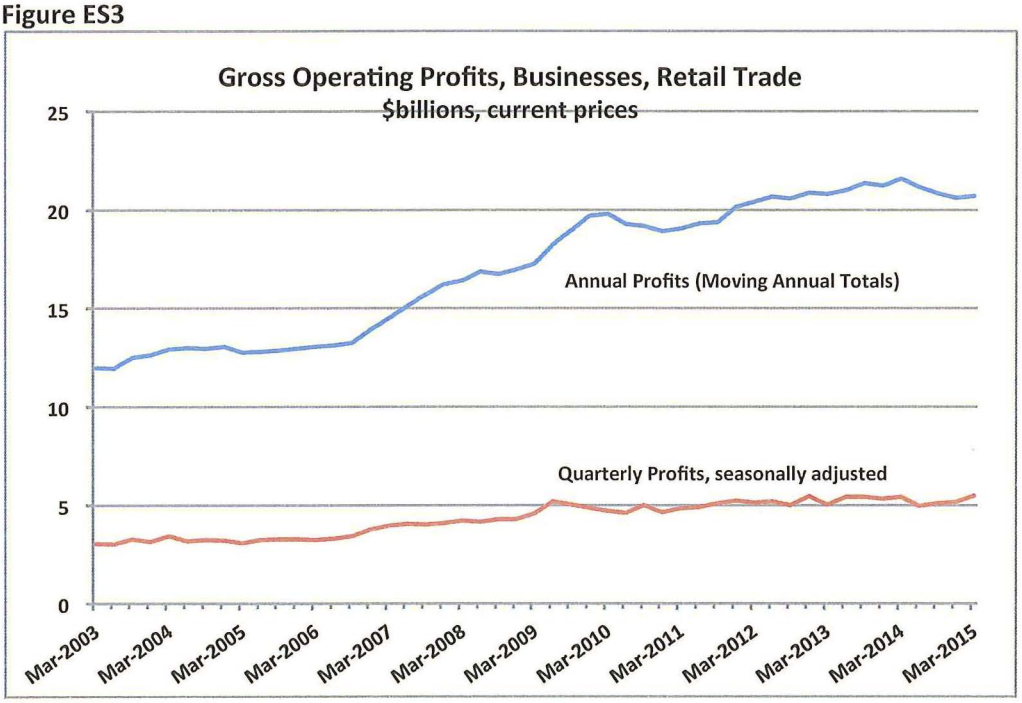
Source: Calculations by Fulcrum Economics Australia, based on data from ABS cat. no. 8501 *Retail Trade* and ABS cat. no. 5206.0 *National Accounts*; accessed via www.abs.gov.au
n.a. = not yet available

Figure ES2



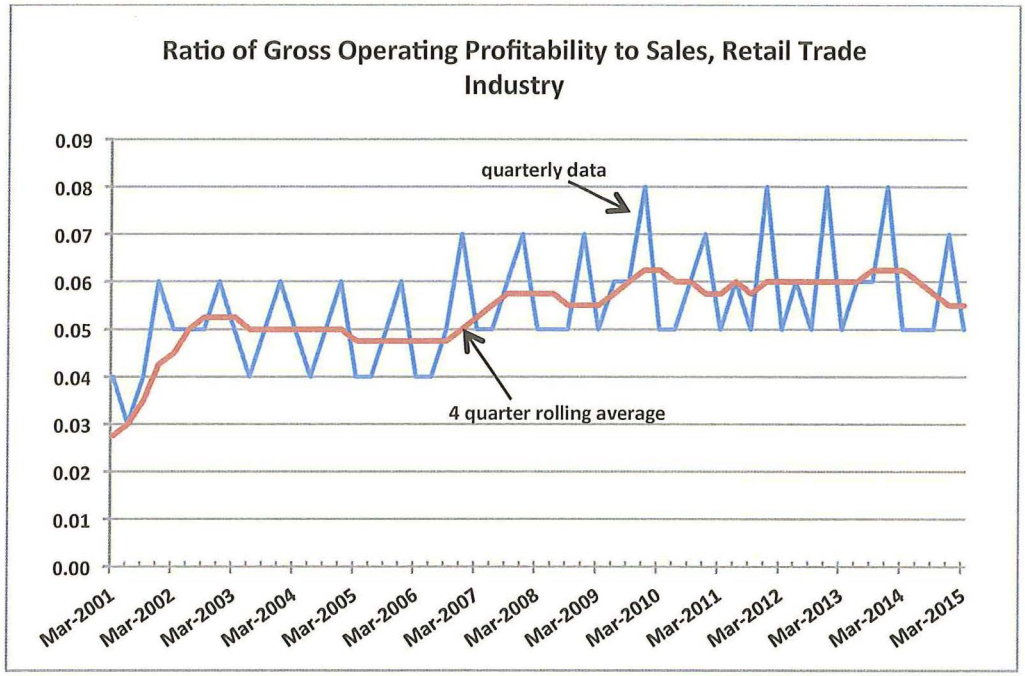
Source: ABS cat. no. 5676.0 *Business Indicators*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Figure ES3



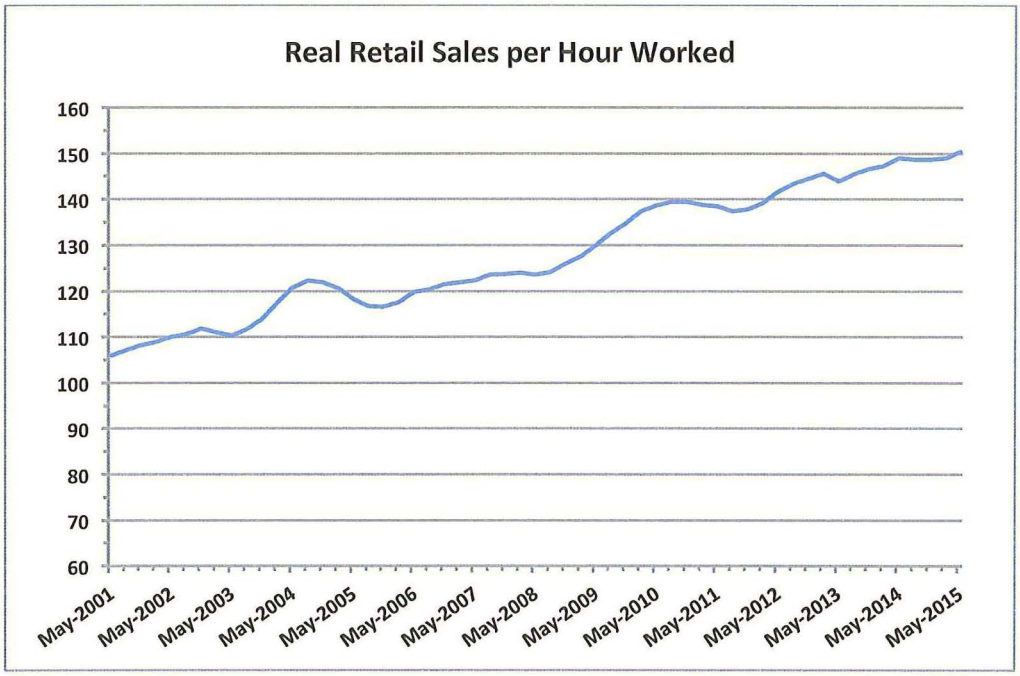
Source: ABS cat. no. 5676.0 *Business Indicators*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Figure ES4



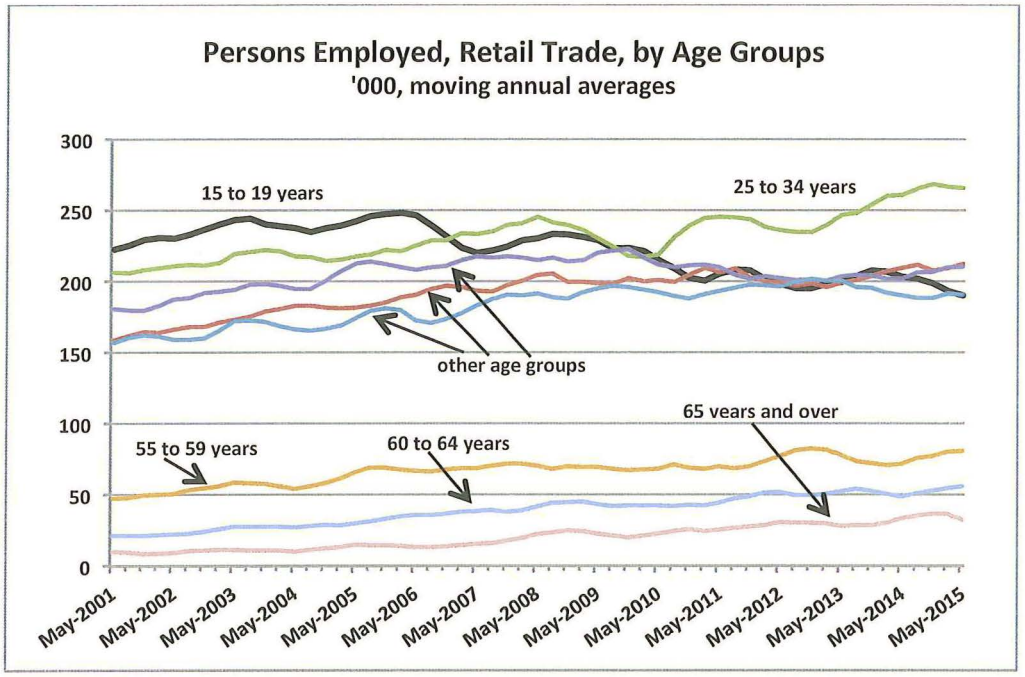
Source: ABS cat. no. 5676.0 *Business Indicators*, accessed via www.abs.gov.au; and calculations by Fulcrum Economics Australia

Figure ES5



Source: Calculations by Fulcrum Economics Australia, based on data from ABS cat. no. 8501.0 Retail Trade and ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed Quarterly*, accessed via www.abs.gov.au

Figure ES6



Source: ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

* This data is only available in 'original terms' and, further, is only collected one 'reference week' per quarter. Thus while not suitable for some purposes it is suitable for exhibiting the overall trends in employment in periods of time.

1. Introduction

The author of this report, Mr Kevin Kirchner, was engaged by the SDA to undertake a critique of Part One of the report prepared by Dr Sean Sands of the ACRS, Monash Business School, Monash University, entitled "Retail Award Research".

*** Hereafter, throughout the remainder of this report, I refer to the report by Dr Sands as 'the Sands Report' and to myself in the first person. ***

Part One of the Sands Report involved *"...analysis of available secondary data on industry conditions and trade performance to assess the current state of the retail industry. This process involved reviewing and updating data from the Kitchener (sic) and Covick (2012) report."* (p. 15 Sands Report).

From the Executive Summary of the Sands Report it seems that the main finding of Part One is captured by the following sentence:

"The slowdown in retail sales in real prices, decline in retail firm operating profitability, increase in retail business closures and aggregate hours worked not recovering to 2007 peak, indicates that despite some improvement since 2012, the retail industry continues to struggle."

In this report I review each of the measures Dr Sands considered to arrive at this conclusion, giving consideration to both the appropriateness of these measures and to Dr Sands' interpretations of them.

However, before doing so it is appropriate to note that the wording of Dr Sands' conclusion is itself a source of some concern. The wording is imprecise and as such has the potential to create perceptions that are not warranted, even if Dr Sands' analysis were correct. (Which, in fact, it is not. To the contrary, his analysis contains many significant errors and is a long way from being correct. This includes his overall conclusion that "... the retail industry continues to struggle".) Thus, for example, where Dr Sands refers to a "slowdown in retail sales in real prices" he presumably means a slowdown in the *growth* of retail sales in real terms, a description which paints a very different picture (and which is still wrong in any event). Similarly, any reference to "retail firm operating profitability" is a misrepresentation since the data he uses to analyse the situation in respect of retail profitability refers to *total* industry data, *not* the profits of individual retail firms. And there are other worrying errors in the way in which Dr Sands has characterised his conclusion. But rather than point them out here they are dealt with in detail within the main text of this report.

A Note on the Data Used in This Report

The majority of the data used in undertaking the analysis of this report was Australian Bureau of Statistics (ABS) data.

The ABS uses two definitions of 'Retail Trade' across its various data collections. Appendix C to this report discusses the compatibility of the resultant ABS data series as a basis for analysing trends and developments within the "General Retail" industry as defined within the General Retail Industry Award 2010 (GRIA2010). The conclusion of this discussion, however, is that it is possible to use the ABS data in a way such that the results of the analysis undertaken provide a true picture of the state of the "General Retail Industry".

2. Analysis of the State of the Australian Retail Industry

2.1 Offline Retail Sales

The first measure Dr Sands considers is what he refers to as "offline retail sales" which, judging by the way he discusses this data in his text, he interprets as being 'retail purchases by Australian residents excluding on-line purchases'. Unfortunately, this is not a correct interpretation of the data Dr Sands has analysed, being retail turnover from the ABS Retail Trade data series (cat. no. 8501.0). The ABS Retail Trade series refers to retail sales *by Australia-resident retailers* and *includes* on-line sales by these retailers. Consequently it is wrong to refer to this data as "offline retail sales". The only online retail sales *not* included in these data is online purchases by Australian residents from *non-resident* retailers.[1]

Nevertheless, the ABS Retail Trade series is the correct data to use to assess the sales performance of Australian based retailers. Furthermore, in one sense at least Dr Sands' error is not a major error since online retail sales still represent a very small percentage of total Australian retail sales. A fuller discussion of online retail sales is provided later in this report.

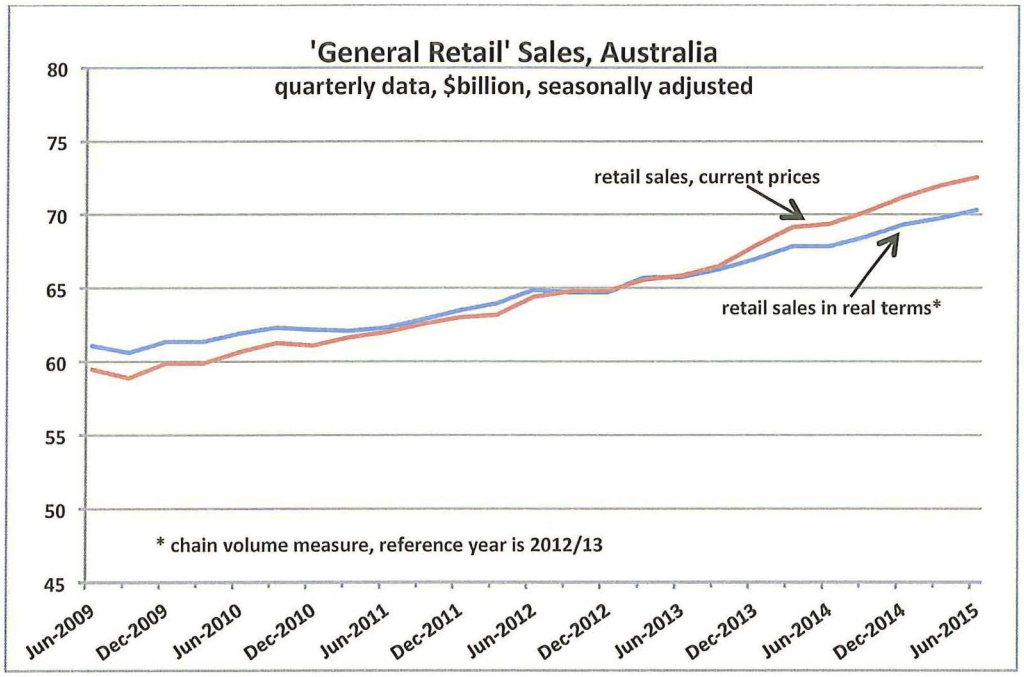
For the sake of clarity and accuracy, however, I refer to 'retail sales' in the following analysis, not 'offline retail sales'.

Figures 1 and 2 recreate the main data Dr Sands used to review the state of retail sales in Australia (corresponding to Figures 3 and 4 in his report). Figure 1 shows total 'general retail' sales in Australia, while Figure 2 illustrates this data on a per capita basis. 'General retail' refers to all sectors of the retail industry as defined by the ABS for its Retail Trade data series *minus* the cafes, restaurants and takeaway food sectors. The resulting data (ie called here 'general retail') closely corresponds to the retail industry coverage of the General Retail Industry Award 2010 (GRIA2010), such that any trends in this data can safely be assumed to represent trends in the industry coverage of the GRIA2010.

The key point to note from Figures 1 and 2 is the sustained growth of retail sales in real terms over the period 2010 to the latest period for which data is available (being the June quarter 2015).

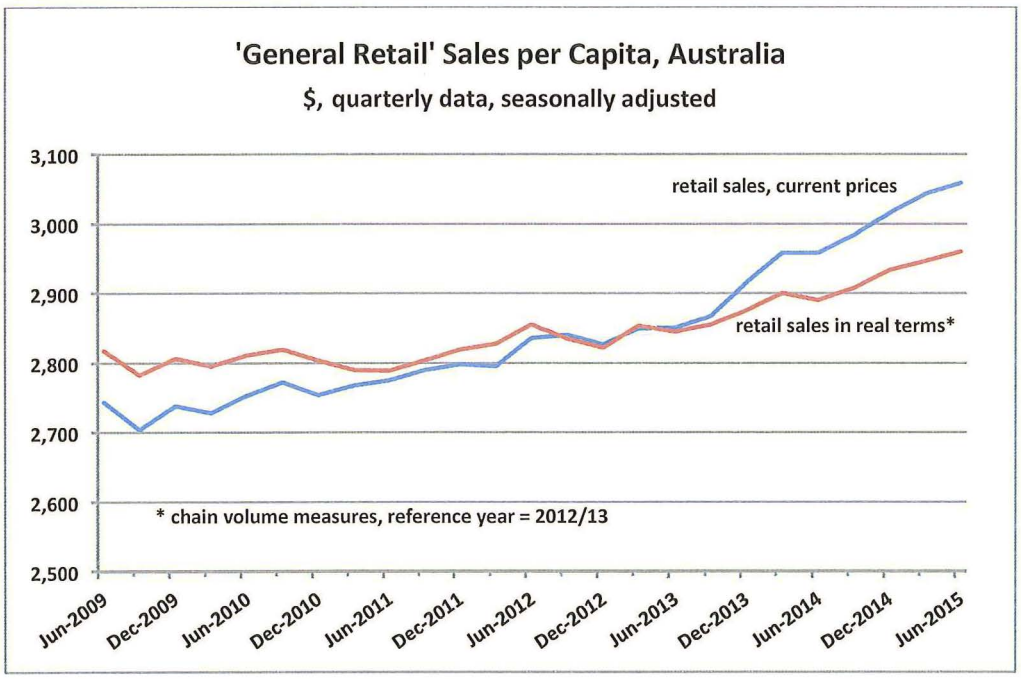
[1] Refer ABS cat. no. 8501.0.55.007 *Information Paper, Management of Online Retail Trade in Macroeconomic Statistics, Australia, 2013.*

Figure 1



Source: ABS cat. no. 8501 *Retail Trade*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Figure 2



Source: ABS cat. no. 8501 *Retail Trade*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Dr Sands in his report, however, focuses on the fact that retail sales in real terms have not grown as strongly as retail sales in current price terms in recent years. He suggests that this indicates some weakness in retail sales, with growth in retail sales over this period being due mainly to *"...inflation or rising prices"* (p. 19).[2] His conclusion is that the growth of retail sales *"... remains relatively incremental"* (p. 19). Indeed, Dr Sands focuses repeatedly throughout his report on the fact that growth in real terms has been less than growth in nominal (or current price) terms. ***In doing so he simply illustrates his lack of understanding and appreciation of the significance of real price data.***

The whole point of real price data (eg retail sales in real terms) *is to remove* the impact of changes in prices, so that the *true underlying situation* can be properly assessed. That is, what is important is *not* the difference between real price data and nominal price data, ***but rather what matters is the trend in the real price data. It is changes in real price data which captures the true growth of the economy or of whatever economic variable is the subject of assessment.*** This is explained in more detail in the accompanying footnote.[3]

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[2] I am not sure what the difference is between "inflation" and "rising prices", as inflation is simply a measure of the rate of change in prices.

[3] Two examples are given to illustrate the significance of real price data. First, consider two persons, each on an income in year 1 of $100. In year 2 person A's income increases to $120, while person B's income increases to $140. Therefore person B is now better off than person A, yes? Actually, it depends. Suppose person A lives in an economy where there was no inflation, so that prices were constant from year 1 to year 2. Person B, however, lives in an economy where prices increased 30% between year 1 and year 2. Consequently, person A's real income in year 2 remains at $120, while person B' real income (measured in year 2 prices) has increased to only $112. In short, person A can afford to buy more in year 2 than can person B. Hence person A is better off than person B. The whole point is that it is what we can afford to buy with our incomes that matters (ie from the point of view of our standard of living), *not* how much income we have.

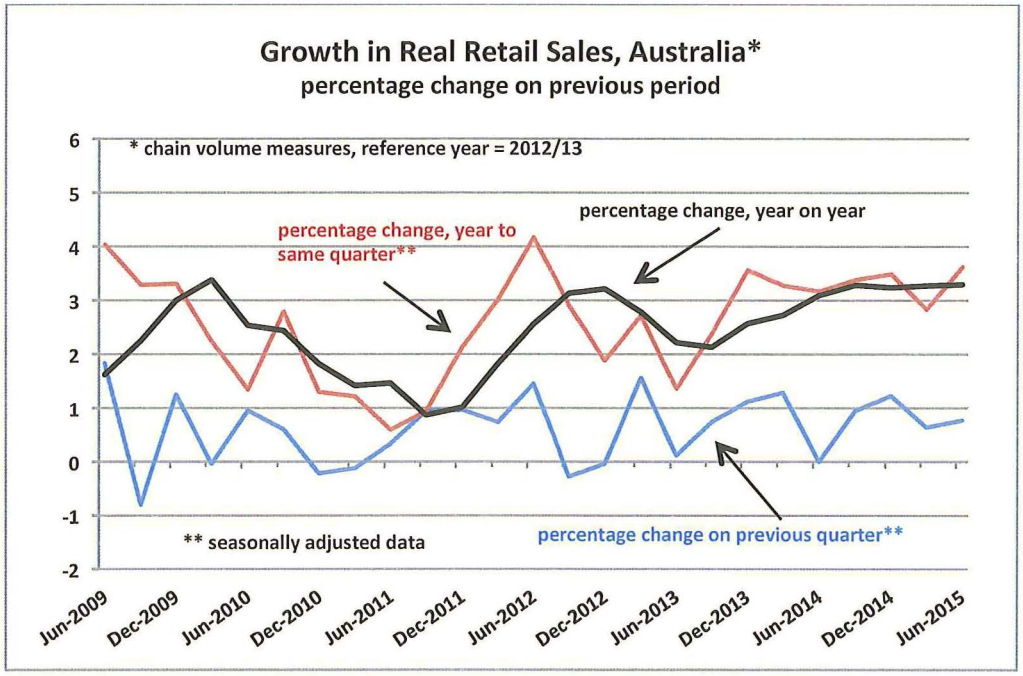
As a second example, consider an economy in which the only retail item for sale is bags of flour. In year 1 a bag of flour costs $2 and one million bags are sold, giving total retail sales of $2million. Suppose that in year 2 total retail sales increase to $3million, in current prices. Does this indicate that both the economy and the retail industry have grown? Again, it depends. If the price of a bag of flour has remained at $2 then this means that in year 2 sales of bags of flour increased to 1.5 million, so that yes both the retail industry and the economy have grown. (Although, admittedly the level of growth of the economy depends upon whether or not the additional bags of flour were produced in that economy.)

But what if the price of bags had flour had increased to $3 in year 2? If so, there has been no growth of the economy and no growth of the retail industry, as total sales of bags of flour would still be 1 million.

Figure 3 illustrates the rate of growth of real retail sales over recent years (ie in percentage terms). Three measures of growth are shown, but the one which best captures the true overall situation with respect to the growth of retail sales is the year-on-year measure.[4] This measure shows that the growth of retail sales has remained *positive* over recent years *in real terms*, generally exceeding 2 per cent growth per annum throughout the period since 2010; and exceeding 3 per growth over the past twelve months (to June 2015).

To put this growth in perspective it can be noted that growth in real retail sales was generally less than growth in real GDP over this period, but not markedly so[5]. In turn, it can be noted that growth in real GDP over this period was less than its long run average – approximately 2.5% per annum compared to 3.5% per annum. Taken together, this data indicates growth in retail sales in the period since 2010 is better characterised as "modest" rather than as "weak". Furthermore, to properly complete the picture, it should be noted growth of real retail seals has lifted in the past two years, up 3.1% in 2013/14 and up a further 3.3% in 2014/15. Data is provided at Table 1.

Figure 3



Source: ABS cat. no. 8501 *Retail Trade*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

[4] The year-on-year growth shown in Figure 3 (and at Table 2) differs from that shown in Figure 2 of Dr Sands' report for two reasons. First, Dr Sands shows growth in retail sale expressed in nominal terms, not in real terms. Second, it appears that Dr Sands' measure is actually 'year to' growth, not 'year on year' growth.

[5] Growth in real GDP (ie Gross Domestic Product) is the most commonly used measure of economic growth.

Table 1

Growth in Real Retail Sales and in Real GDP

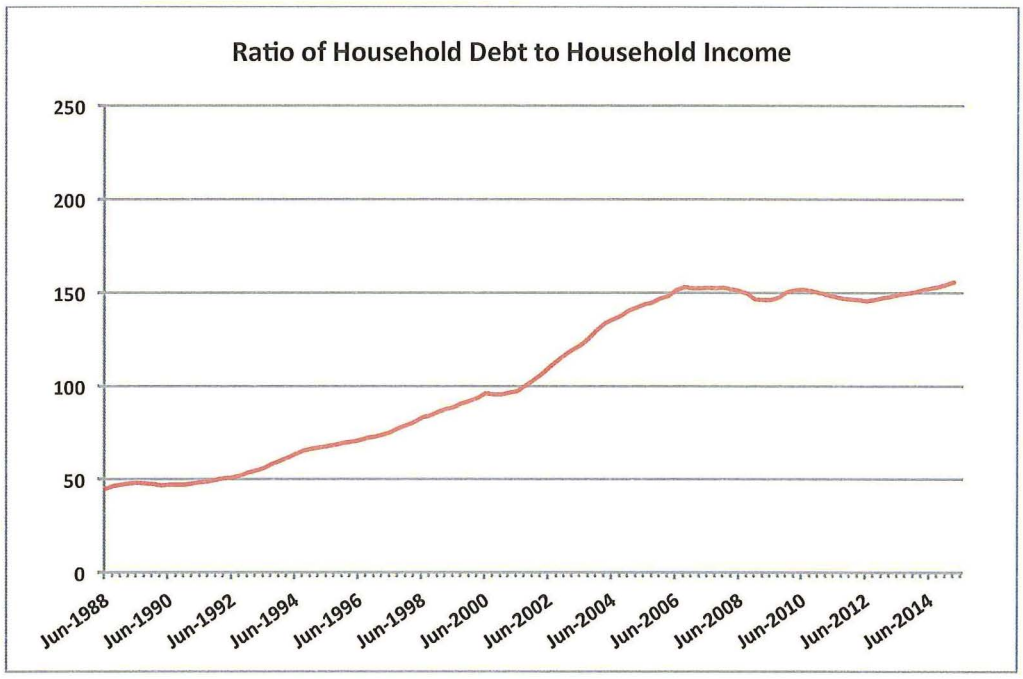
(percentage change, year on year)

	Retail Sales	GDP
2009/10	2.5	2.0
2010/11	1.5	2.3
2011/12	2.6	3.7
2012/13	2.2	2.5
2013/14	3.1	2.5
2014/15	3.3	n.a.

Source: Calculations by Fulcrum Economics Australia, based on data from ABS cat. no. 8501 *Retail Trade* and ABS cat. no. 5206.0 *National Accounts*; accessed via www.abs.gov.au
n.a. = not yet available

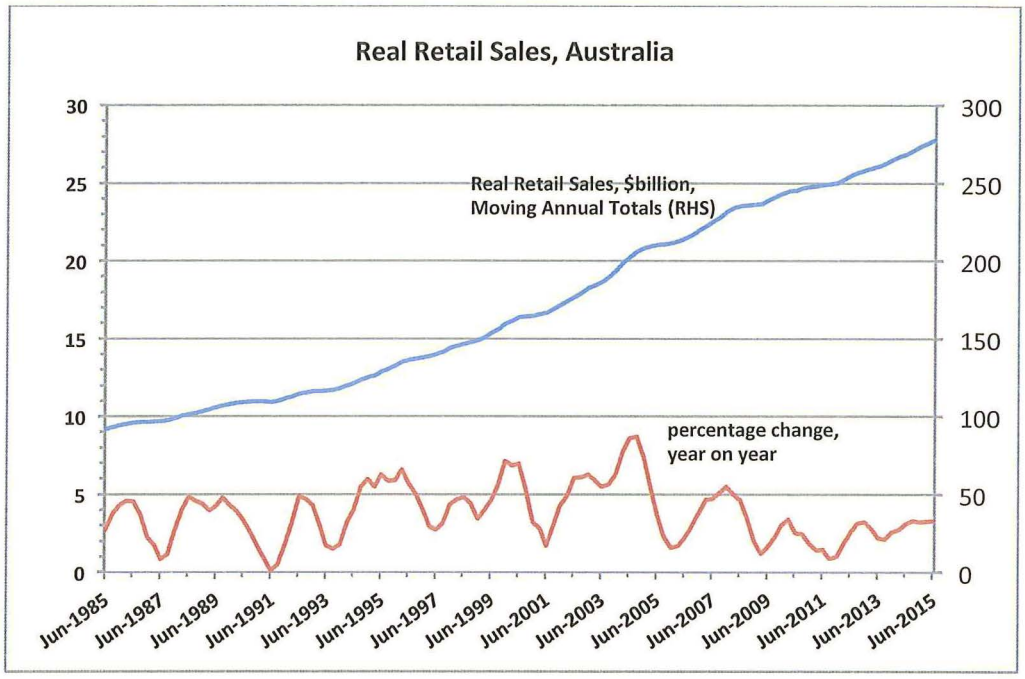
To further put the slower growth or retail sales in recent years in perspective it can be noted that the period 1994 to 2007 was a 'boom period' for the Australian economy overall and for the retail trade sector. Sustained strong growth in incomes in this period (partly on the back of the mining boom), low levels of unemployment, low interest rates and high levels of consumer confidence resulted in a substantial increase in the willingness of households to borrow and to spend. The end results are illustrated by Figures 4 and 5, and by Table 2.

Figure 4



Source: Reserve Bank of Australia (RBA), accessed via www.rba.gov.au

Figure 5



Source: Calculations by Fulcrum Economics Australia, based on data from ABS cat. no. 8501 *Retail Trade*; accessed via www.abs.gov.au

Table 2

Long Term Growth Trends, Retail Trade Industry

year on year, percentage change

	Av. Annual Growth in Real Retail Sales	Average Annual Growth in Real Gross Value Added of the Retail Trade Industry
	%	%
1984/85 – 1989/90	3.5	1.7
1989/90 – 1990/91	0.1	-0.5
1990/91 – 1996/97	4.2	4.0
1996/97 – 2007/08	4.8	4.7
2007/08 -2009/10	2.1	1.0
2009/10 – 2013/14	2.3	2.7
2014/15	3.3	n.a.

Source: Calculations by Fulcrum Economics Australia, based on data from ABS cat. no. 8501 *Retail Trade* and cat. no. 5206.0 *National Accounts*; accessed via www.abs.gov.au

Figure 5 shows that in the period 1994 to 2007, year on year growth in real retail sales regularly exceeded 5 per cent; while Table 2 illustrates the very strong per annum average growth across the period 1990/91 through to 2007/08.

The Global Financial Crisis in 2007/08 bought an end to this extended period of sustained strong growth. But, as also shown by Figure 5, *it did not lead to a fall in retail sales*. Instead, retail sales continued to grow in real terms post 2007, just at a slower rate than prior to 2007.

To my mind, when the above data is considered in its totality the correct interpretation is that Australian retail sales remain at a very healthy level, notwithstanding the slower growth in retail sales over recent years.

And, of course, the fact that retail sales growth has lifted in the past two years only reinforces this conclusion.

The bottom line is that it is simply not possible, on the back of retail sales data at least to accept Dr Sands' conclusion that the Australian retail industry "...continues to struggle". It may be that other data, for example data on profitability or investment or entries and exits, paints a different picture. It is to these other data I now turn.[6]

2.2 Profitability

2.2.1 Total Profits

It must be said, albeit regrettably, that overall Dr Sands' analysis of the profitability of the retail industry makes little sense. It is confused and his use and interpretation of the data leaves much to be desired.

Nevertheless he does manage to conclude, more or less correctly, that *"... over the long term, profitability in Retail and All Industries has grown"* (p.27). I say 'more or less correctly' because he heads this section 'firm profitability' and to a large extent he discusses this data as if it reflects *individual* firm profitability. It doesn't. Rather the ABS data quoted refers to *total* industry profits. Consequently, his above conclusion should read more along the lines: *'... total profits across both the retail industry and for all industries in aggregate have grown over the long term'.*

[6] Dr Sands in his analysis also considers some other aspects of retail sales, notably analysing them by category and by State, but this analysis seems to add nothing to his conclusions and hence I decided not to spend time commenting on this aspect of his analysis.

Dr Sands goes on to suggest, however, that since December 2004 *"...retail business operating profits have fallen below All Industries except for the June 2009 and December 2012 quarters."* All one can do is guess at what Dr Sands means, for by itself this statement makes no sense. (It goes without saying that the total profits of the retail sector will be less than the total profits of all industries!) What Dr Sands appears to be referring to is the pattern illustrated by his Figure 10, which graphs gross operating profits for the 'retail industry' and for 'all industries', with each profit series expressed as an index. Dr Sands makes much of the fact that at some points in this diagram the retail-profit line falls below the all-industries-profit line. His interpretation of this, however, is complete nonsense. It does not mean, as he suggests, that *"...retail business operating profits have fallen below All Industries [profits] except for the June 2009 and December 2012 quarters."* Whatever this statement might actually mean!

Instead, all that Figure 10 in Dr Sands report indicates is that over the period as a whole (March quarter 2001 to December quarter 2014) total profits of the retail industry grew at a slightly lesser rate than the profits of all industries combined.

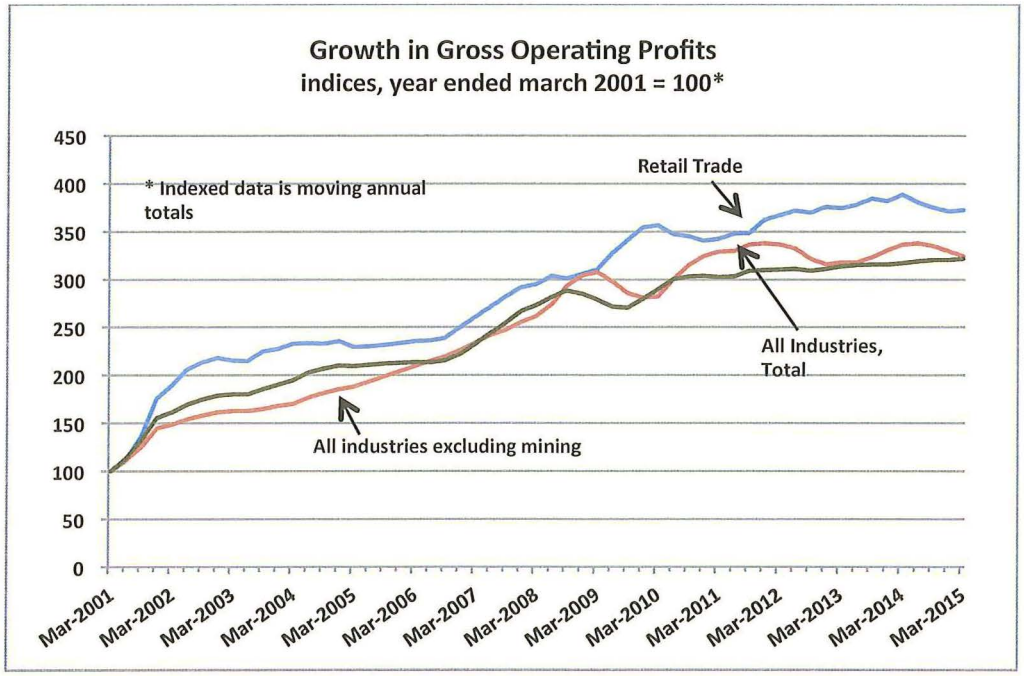
But even this conclusion – as weak as it is - is debatable. Dr Sands has based his conclusion on quarterly data. If the same graph is replicated on the basis of annual data, then a slightly different result is obtained. Further, it should be noted that the results of any analysis of this sort can be very much dependent upon the starting and end points chosen. In this case, as Figure 6 illustrates, even a difference of a couple of quarters can bring about a different result. Figure 6 graphs industry profits calculated on a moving annual total (MAT) basis, so that all data shown is for the 'year ended' at each respective quarter.

When expressed on a MAT basis, with the year ended March quarter 2001 as the starting point and the year ended March quarter 2015 as the end point (being the latest data available at the time of writing), it is now the retail industry which has recorded the stronger profit growth over the period.

However, it should also be clear from Figure 6 that if the starting point had been the year ended March 2002 instead of the year ended March 2001, then the result would have been the same as that obtained by Dr Sands, namely profit growth of the retail industry would have increased slightly less than profit growth of 'all industries', in the period to December 2014 (and to March 2015).

At the end of the day, however, there is not a lot to take from this data, since over long periods of time there is no reason why the profit growth of one industry should match that of other industries. To the contrary, industries come and go as technologies, tastes and incomes change.

Figure 6



Source: ABS cat. no. 5676.0 *Business Indicators*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Nevertheless, if anything, the fact that the profit growth of the retail industry has continued to match the profit growth of the average of all industries provides a strong indication that the retail industry remains in a very healthy state, notwithstanding the slowdown in profit growth over recent years.

In his consideration of the more recent profit performance of the Australian retail industry Dr Sands summarised his findings by saying that industry profits fell over the period 2012 to 2014. However, he comes to this conclusion only by being very selective with the quarters he compares. Consequently, his conclusion has little validity. As I have already noted, it is more informative and appropriate to compare annual profits (or overall trends) than to compare selected quarterly profits. Figure 6 clearly shows that the overall trend in retail industry profits in recent years (since around 2010) has generally been upwards, albeit with a small decline in total profits being evident in the most recent 12 month period.

A more accurate interpretation, than that of Dr Sands, of the profit performance of the retail industry therefore would be to say that profits remain at a strong level, notwithstanding the slight decline in profits in the second half of 2014. The continued strength of retail profits is evident when current profits are compared to those achieved through the earlier 2000's (Figure 6).

Another way of summarising the continued strength of retail profits is to note that by 2012 total retail industry profits had moved back above the level reached at the end of the 'boom period' (1994 to 2008) and have since remained above this level.

For the sake of completeness, to end this section, Figure 7 illustrates retail industry profits on both a MAT basis and a quarterly basis. The one additional relevant point to take from Figure 7 is that the latest profit result, for the March quarter 2015, suggests that retail profits are again growing.

Figure 7

Source: ABS cat. no. 5676.0 *Business Indicators*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

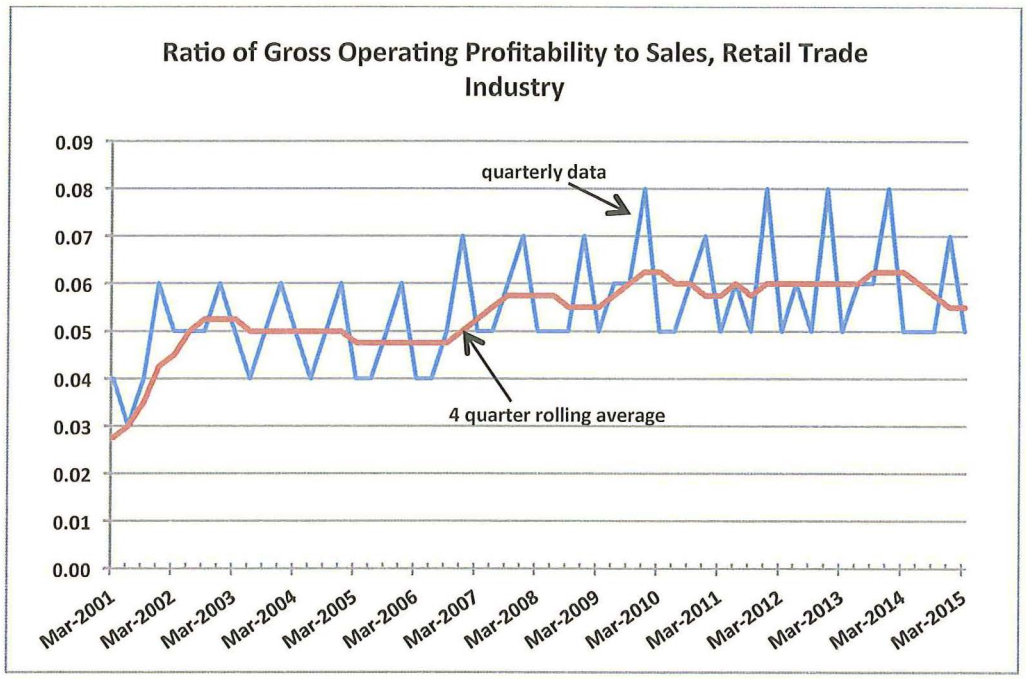
2.2.2 Profit Margins

Dr Sands makes one other claim in this section of his report (section 1.1.7) which deserves comment, namely that "...actual retail profit margins are decreasing" (p. 28). His logic in arriving at this conclusion is, to say the least, perplexing. It was logic which I was not able to follow.

The actual situation in respect of retail profit margins is illustrated by Figure 8.

Figure 8 indicates that while there has been a slight decline in the average retail profit margin in the past twelve months, nevertheless across the period 2010 to the current time retail profit margins have remained at a high level compared to earlier periods. (Note: In Figure 8, 0.05 (for example) equates to a profit margin of 5%.)

Figure 8



Source: ABS cat. no. 5676.0 *Business Indicators*, accessed via www.abs.gov.au; and calculations by Fulcrum Economics Australia

2.3 Wages

The next logical area of discussion, following on from that on profits, is trends in growth in the cost of labour. Dr Sands addresses these trends at section 1.2.5 of this report (pp 43 – 45).

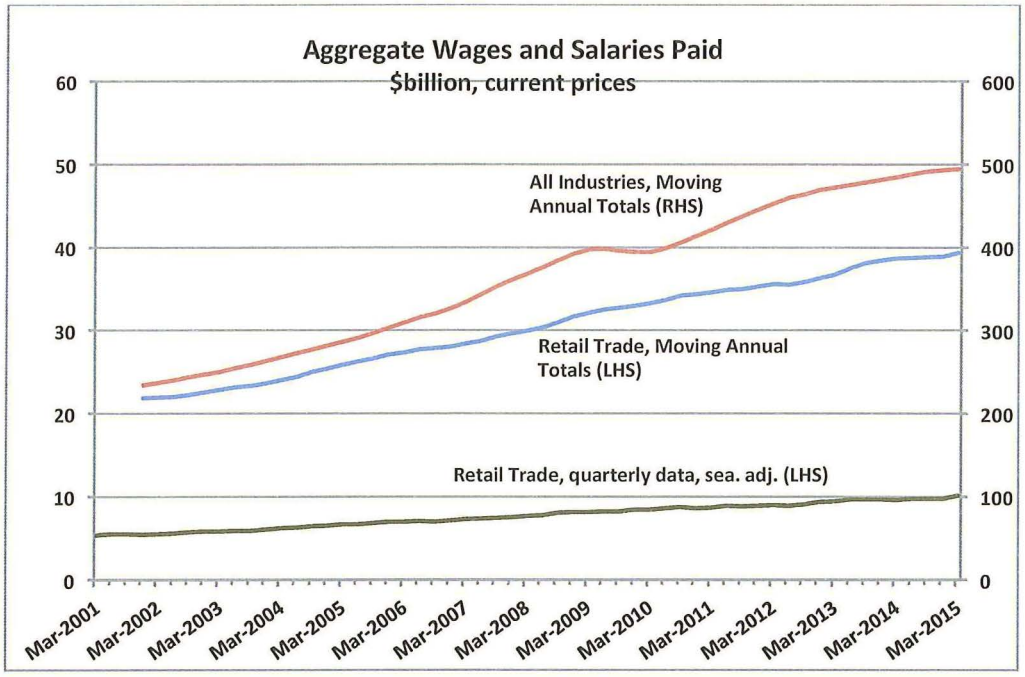
Dr Sands commences his discussion by suggesting that "... retail wages have been growing at a higher rate than the 'all industries' average [in the period since 2012]" (p. 43). This statement is incorrect. He is again misinterpreting the data. What the data actually says is that the total wages bill of the retail industry has grown at a faster rate than the total wages bill of all industries in aggregate. This is a very different matter from Dr Sands' interpretation; one which does not necessarily have negative connotations for the state of the retail industry.

Furthermore, a look at the data shows – and even Dr Sands' own graphs show – that in actual fact it was only across a very small period of time, around 2013, that the total wages bill grew faster in the retail sector than across all industries on average. Indeed, when the analysis is done on a 'moving annual total' basis, as per Figure 9, the period of stronger growth is hardly even evident.

To the extent that the total wages bill for the retail industry has grown faster than for all industries in aggregate there are two possible explanations: either wage rates have grown

faster in the retail industry than across all industries on average, or employment has grown more strongly in the retail sector than across all industries on average.

Figure 9



Source: ABS cat. no. 5676.0 *Business Indicators, Australia*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

It is possible from available ABS data to calculate estimates of the average hourly wage paid to employees in the retail sector and across all industries in aggregate – albeit fairly rough estimates (because of the limitations of the available data). Nevertheless, the data is sufficiently strong to enable some conclusions to be drawn. The results of the calculations are illustrated by Figure 10.

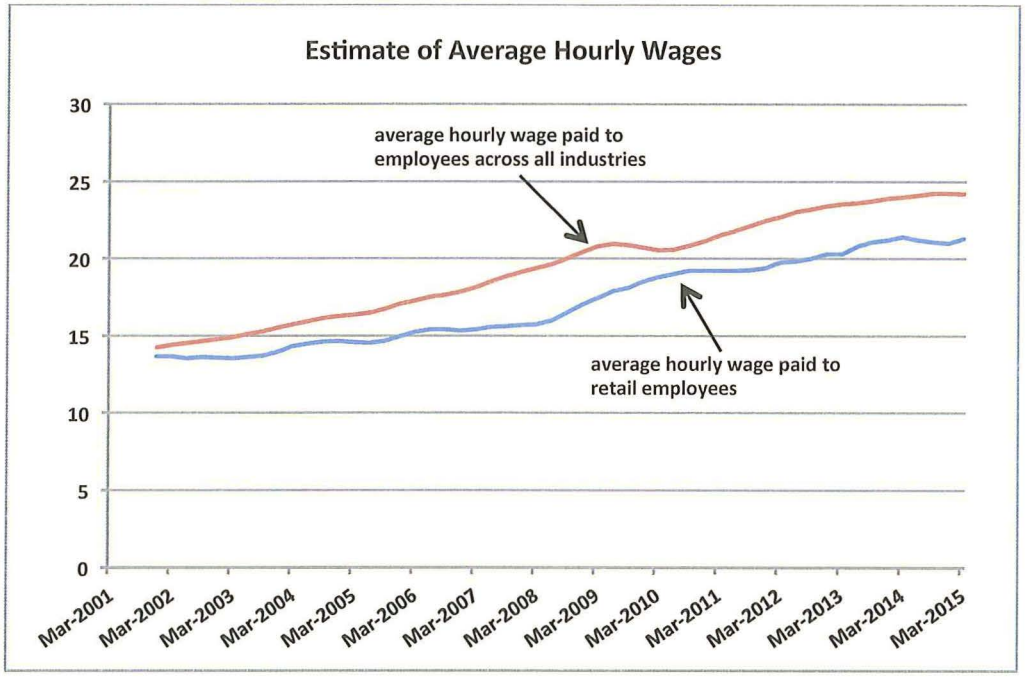
Figure 10 makes it clear that across the period 2010 to the current time the average hourly wage received by retail employees has not grown at a faster rate than the "all industries" average wage.

Another piece of data analysed by Dr Sands in this section of his report, to support his (wrong) claim that wages have been increasing more rapidly in the retail industry than in other industries, was the ratio of sales revenue to wages paid. Dr Sands notes that since 2012 this ratio has varied between 9 and 10. He then goes on to draw the following conclusion"

> ***"... this means that wages are growing at 9% more than sales, putting significant downward pressure on operating margins for retailers."(p. 45)***

This, of course, means no such thing. This conclusion is totally wrong.

Figure 10



Source: Calculations by Fulcrum Economics Australia, based on data from ABS cat. no. 5676.0 *Business Indicators, Australia* and cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed Quarterly*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

What this data is actually saying is that the total wages bill of the retail industry grew roughly in line with retail sales across this period (ie 2012 to early 2015). (If had not then the ratio would be decreasing or increasing, not remaining stable at between 9 and 10.)

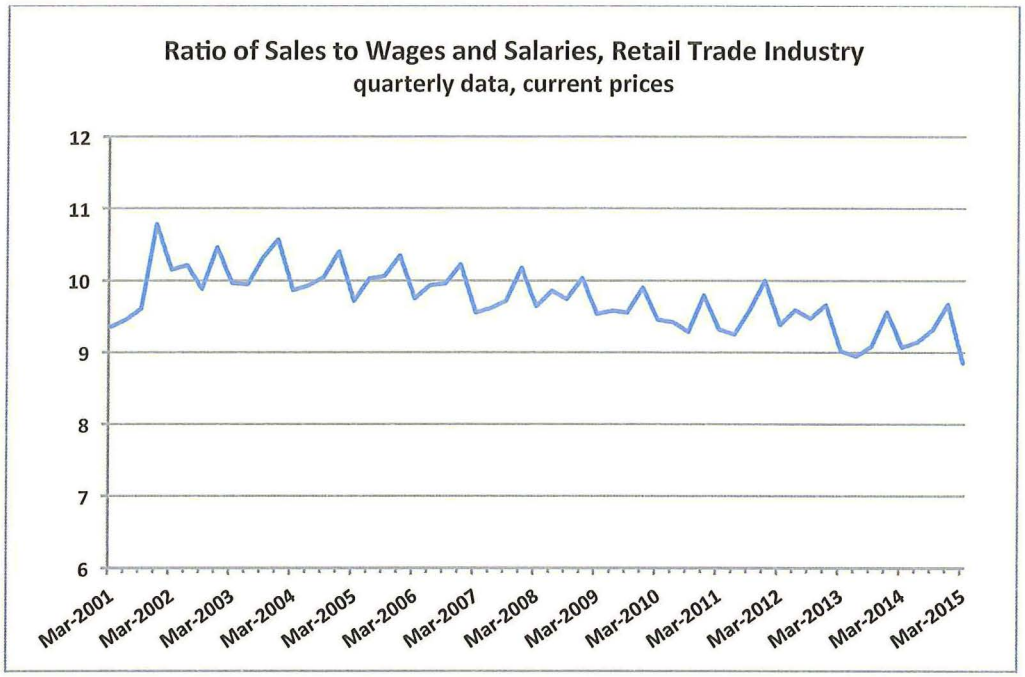
Nevertheless, I note that over the longer term this ratio has declined, as illustrated by Figure 11. But the important thing to note is that this is not a bad thing. As has already been noted, total profits of the retail industry remain at a high level. Add to this the fact that the whole point of our economic system is to bring about increases in living standards (or, more correctly, increases in the well-being of society)[7] then it is quite appropriate that wages are increasing, including as a percentage of sales. The bottom line is that higher living standards across a society as a whole will not be achieved if some sectors of that society are condemned forever to work in low paying jobs.

Furthermore, increases in real wages are appropriate if they are linked to growth in productivity. Figure 12 makes it clear that there has been significant growth in (labour) productivity in the Australian retail industry over the past decade. Indeed, the level of real retail sales per hour worked – which, it seems to me, is a particularly useful measure of labour productivity in the

[7] The problem with referring to 'increases in the well-being of society' is that it is a difficult thing to define and measure. Nevertheless, this is (or should be) the ultimate goal of an economic system.

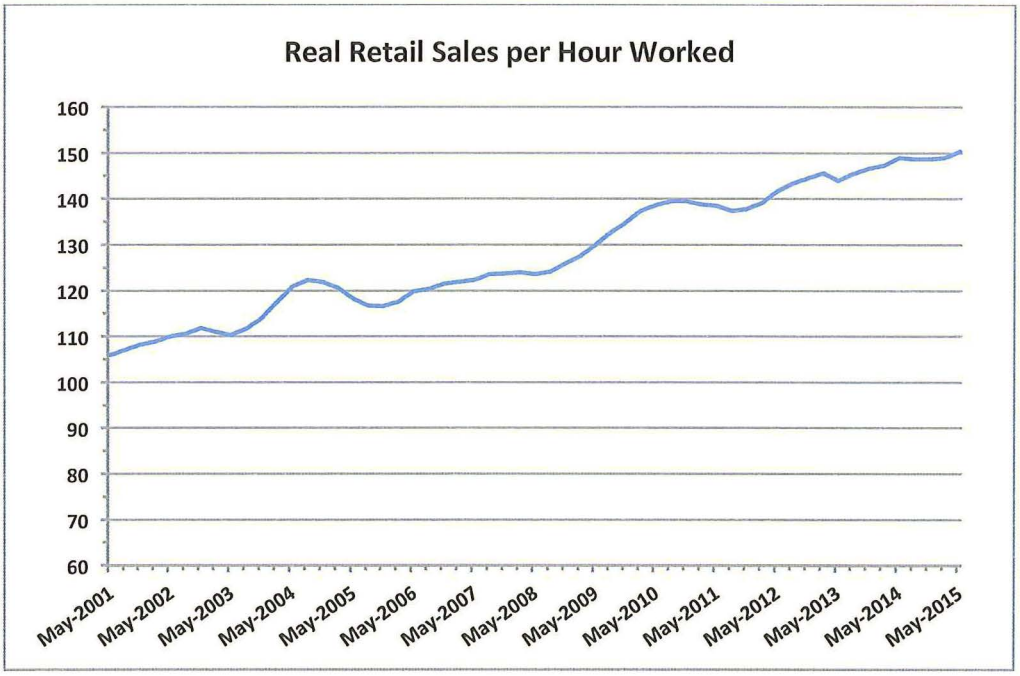
retail industry – has increased around 43% since 2001 (refer Figure 12). This, I suggest, is a very strong growth in productivity.

Figure 11



Source: ABS cat. no. 5676.0 *Business Indicators*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Figure 12



Source: Calculations by Fulcrum Economics Australia, based on data from ABS cat. no. 8501.0 Retail Trade and ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed Quarterly*, accessed via www.abs.gov.au

In summary, combining the results of this section and the previous section, it is clear that:

- ***wages in the retail industry have not generally been growing at a faster rate than wages across the economy as a whole;***
- ***the growth of wages has not prevented retailers from continuing to realise strong profits; and***
- ***there is nothing in either the wages data or the profit data to support the contention that the retail industry "...continues to struggle".***

2.4 Employment

2.4.1 Overall Employment Growth

There are two ways of measuring employment, namely by the number of persons employed or by aggregate hours worked.[8] Figures 13 and 14 show the trends in each for the retail industry. Neither set of data supports Dr Sands' claim that *"...the retail industry continues to struggle".*

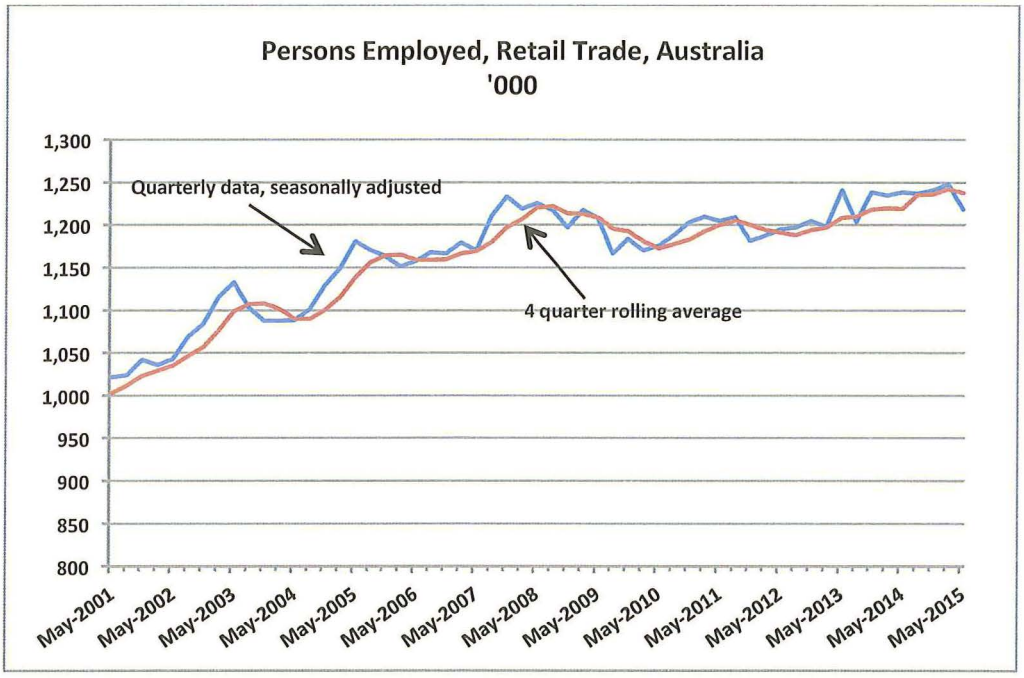
The number of persons employed in the retail industry has continued to climb in recent years, so that average employment across the year ended May 2015 was 3.6 per cent greater than average employment in the year ended May 2010. Over the same time period aggregate hours worked increased 2.3 per cent. These are not strong increases by recent historical standards – refer Figures 13 and 14 – but neither are they consistent with the notion that the retail industry '...continues to struggle'.

In his analysis Dr Sands focuses on the fact that aggregate hours worked in the retail industry in 2014 were still less than the peak achieved in 2007.

However, it is far from clear to me that 2007 is a relevant reference point by which to be judging the current state of the retail industry. It needs to be remembered that 2007 was at the end of a more than decade long period of strong, sustained growth of both the economy and the retail industry (as shown by earlier graphs and discussion in this report).

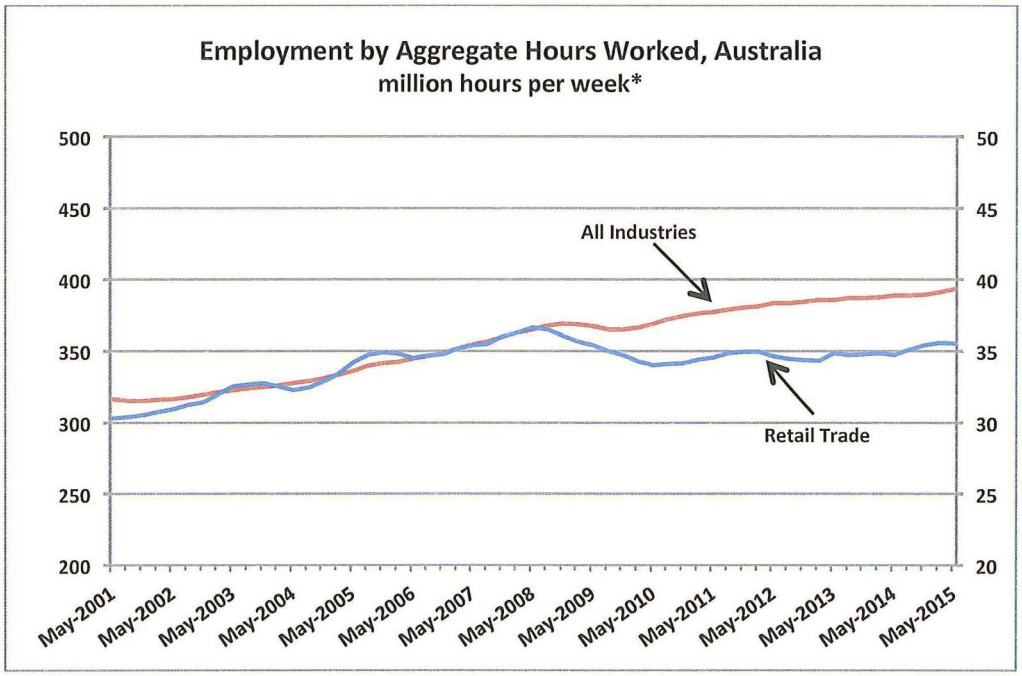
[8] The significance of 'aggregate hours worked' as a measure of employment is illustrated by the following simple example. Suppose that in period 1 there are 10 people employed, each working 40 hours per week. In period 2 there are 20 people employed, but now each only works 10 hours per week. Thus the number of persons employed has doubled (ie increased 100%), but aggregate hours worked has declined, from 400 hours per week to only 200 hours per week (= a 50% decline).

Figure 13



Source: ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

Figure 14



Source: ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly*, accessed via www.abs.gov.au; with calculations by Fulcrum Economics Australia

* This data is only available in 'original terms' and, further, is only collected one 'reference week' per quarter. Thus while not suitable for some purposes it is suitable for exhibiting the overall trends in employment over periods of time.

The advent of the Global Financial Crisis (GFC) in 2008 saw a decline in both persons employed and aggregate hours worked in the retail industry, the result of sharp reversals in both consumer confidence and in the economic outlook in general. Nevertheless, since then there has been a modest recovery in both and, more specifically, employment in the retail industry remains at levels much closer to the 2007/08 peak than to the considerably lower levels of retail employment that existed through the first half of the 2000s – refer again to Figures 13 and 14.

The bottom line is that the only aspect of retail employment trends which perhaps points to some weakness in the retail industry is that growth in employment has remained at a relatively low level in recent years.

On the other hand, absolute levels of employment remain strong when compared to earlier years.

2.4.2 Average Hours Worked

Dr Sands next notes that average hours worked per person in the retail industry has exhibited a long term downward trend. The conclusion Dr Sands draws from this is:

> *"This information, coupled with higher wage growth, provides context to the decline experienced in firm profitability over the last few years. A higher number of employees are working fewer hours and being paid more. In the face of slowing retail sales in real price terms, this results in declining operating margins for retailers."*

Not only is the basic information in this statement wrong, but it is again impossible to follow the logic. As we have already seen, profits in the retail industry in recent years have been sustained at high levels; while it is the total wages bill of the retail industry which has been increasing strongly, more so that individual wage rates. The key piece of data which shows up the lack of logic in this statement, however, is data on operating margins, which shows that operating margins of retailers have <u>not</u> declined in recent years, other than a small decline in the past twelve months – refer again to Figure 8.

Notwithstanding that Dr Sands has got his conclusion about the implications of the decline in average working hours in the retail industry totally wrong it is nevertheless still worth asking, what to make of the decline over recent years in average hours worked in the retail industry?

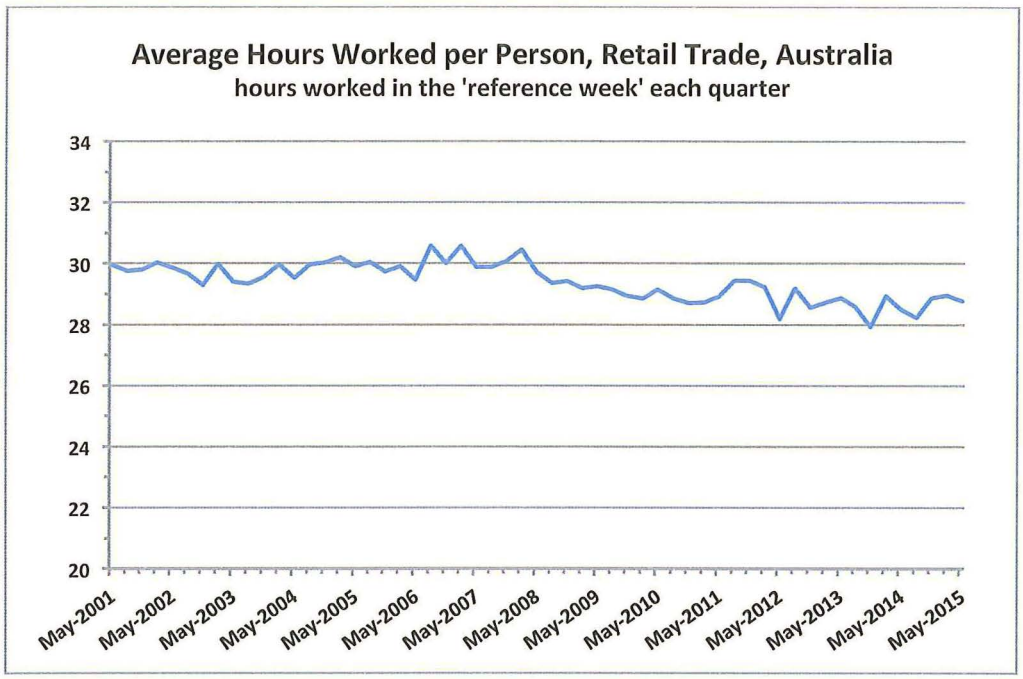
Figure 15 illustrates the relevant data.

From this diagram it can be seen that the majority of the decline in average hours worked occurred across the period 2008 to 2010. One possible explanation of the decline therefore is

that it was simply retailers adjusting to the changed economic conditions and to their own changed expectations of future trading conditions, in the wake of the GFC. A key component of the decline may even simply have been that with the advent of the GFC there was some rationalization of overtime being worked by employees.

Whatever the explanation for the decline in average hours worked it is difficult to see how such a decline can be taken as an indication that the retail industry "...continues to struggle". This is especially as since 2010 the *number* of persons employed in the retail industry has increased, albeit marginally. Exactly why average hours worked per person remain at a lower level that in the high growth period prior to 2007 is simply a matter for further research.

Figure 15



Source: ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly*, accessed via www.abs.gov.au; with calculations by Fulcrum Economics Australia

* This data is only available in 'original terms' and, further, is only collected one 'reference week' per quarter. Thus while not suitable for some purposes it is suitable for exhibiting the overall trends in employment over periods of time.

2.4.3 Youth Employment and Unemployment

Another aspect of the Sands Report which warrants comment is his attempt to link the decline in the number of young people employed in the retail industry to the rise in youth unemployment in recent years (p. 34).

Figures 16 and 17 present the relevant data. Figure 16 shows the *number* of young persons employed in retail; while Figure 17 shows employment of young people according to *aggregate*

hours worked. The data of both Figures 16 and 17 show a marked decline in the employment of 15 to 19 year olds in the retail industry from around 2008. This timing, of course, coincides with the advent of the GFC and the subsequent general slowing of both the Australian economy as a whole and the retail sector.

The really interesting point, however, is that the employment of persons aged 15 to 19 years in the retail industry has continued to decline since 2008, *even as employment among other age groups has picked up.* This fact is illustrated by Figure 18.

Figure 16

Source: ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

* This data is only available in 'original terms' and, further, is only collected one 'reference week' per quarter. Thus while not suitable for some purposes it is suitable for exhibiting the overall trends in employment in periods of time.

To what extent the rise in youth unemployment in recent years is linked to the decline in employment of 15 to 19 year olds in the retail industry in the same period is difficult to say. The reality is that there are many factors which affect the level of employment of any age group. It seems to me that this matter is a question for further research.

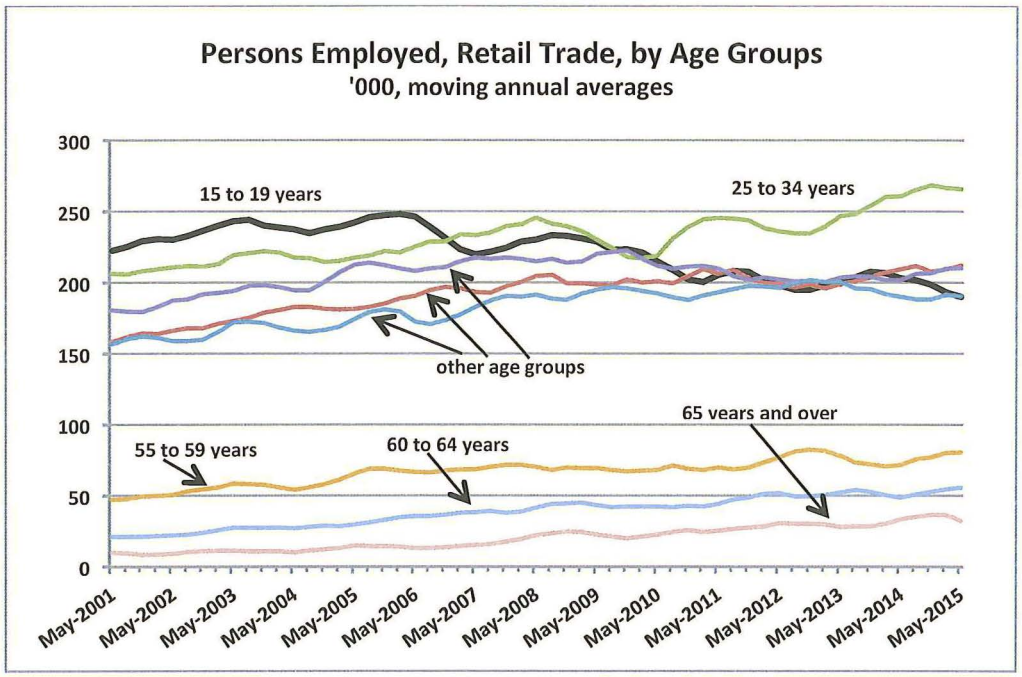
However, perhaps even more interesting is the question of why employment of 15 to 19 year olds in the retail industry has continued to decline even as employment of other groups has increased?

Figure 17

Source: ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

* This data is only available in 'original terms' and, further, is only collected one 'reference week' per quarter. Thus while not suitable for some purposes it is suitable for exhibiting the overall trends in employment in periods of time.

Figure 18



Source: ABS cat. no. 6291.0.55.003 *Labour Force, Australia, Detailed, Quarterly*, accessed via www.abs.gov.au; and Fulcrum Economics Australia

* This data is only available in 'original terms' and, further, is only collected one 'reference week' per quarter. Thus while not suitable for some purposes it is suitable for exhibiting the overall trends in employment in periods of time.

Again, I can think of no ready answer, or even possible explanation, to this dichotomy. My first thought was that maybe it reflected a decrease in the suitable labour pool as more young people chose to remain in full-time education. But the data does not support this possible explanation. Consequently, this too remains an area for further research.

2.5 Online Retail Sales

Dr Sands presents some data on online retail sales in his report, but draws no conclusions from his analysis. Nevertheless, notwithstanding the lack of analysis by Dr Sands, it seems appropriate to give some brief consideration to the issue of online retail sales, since this seems to be a pertinent issue in considering the state of health of the Australian retailing industry (which is the main focus of this critique in light of Dr Sands overall conclusions).

The overall evidence from the various data which have already been presented in this report makes it clear that the Australian retail industry cannot accurately be described as being in a situation where it "... continues to struggle". Consequently, the question that needs to be considered in relation to online retail sales is not whether these sales are contributing to the industry continuing to struggle, but rather in what way might they be having an impact on the local retail industry?

Currently there are two sets of data available for online retail sales, one produced by the National Australia Bank (NAB) and one produced by the Australian Bureau of Statistics (ABS). The NAB survey attempts to provide an estimate of *all* online purchases by Australian residents, while the scope of the ABS survey is (currently) *only* online purchases from Australian based retailers. The ABS also describes their series as "experimental estimates". Although, in my opinion, this does not make these data inferior in any way to the NAB data.

The latest available NAB survey results indicate that online retail purchases by Australian residents totalled $16.9 billion in the year to April 2015, of which 75.5% (or $12.8 billion) was spent with Australian based retailers. (Meaning that approximately $4.1 billion went to buying goods from overseas based retailers.) In comparison, the ABS estimates that online purchases from Australian based retailers was only $8.0 billion in the same period. The ABS suggests that "scope limitations" may explain why their estimates of online sales have been less that of other bodies, such as those of the NAB (ABS cat. no. 8501.0.55.007).

Perhaps the important thing therefore to note is that the scope of the ABS's online sales data collection *is the same as the scope of its Retail Trade data collection* (ABS cat. no. 8501.0).

Consequently, it is more correct to compare the ABS online sales estimates with data for total retail sales from the 8501.0 series than it is to compare the NAB data. Hence, using the ABS estimates of domestic online retail sales ($8.0 billion in the year to April 2015) indicates that online retail purchases from domestic retailers accounted for approximately 3.3% of total Australian 'general retail' sales in this period. The comparable figure using the NAB measure of online sales is 5.2% - but, as already noted, this is likely an over-estimate given that the scope of the NAB's definition of retail trade seems to be greater than the ABS's definition of retail trade (as used in its retail sales data collections).

The NAB data indicates online purchases from *overseas based retailers* of around $4.1 billion in the 12 months to April 2015, which is equal to 2.7% of domestic 'general retail' sales. But if the NAB number is scaled back to reflect the fact that the NAB industry coverage seems to be considerably broader than the ABS definition of 'retail trade', then the actual percentage is more likely to be around 1.1%.[9]

What can we conclude from this analysis? In truth, very little. To my mind it remains an area for further research. But a few general observations can be made.

- ***i) The majority of online purchases by Australian residents are from locally based retailers. Furthermore, the latest NAB survey indicates that this is an upwards trend. Consequently, while online retail sales may well present a threat for some Australian retailers, for others it represents an opportunity.***
- ***ii) To date, online purchases from overseas retailers represent a very small segment of the market, perhaps a level of sales equal to as little as 1.1% of local 'general retail' sales.***
  - ***Furthermore, the latest NAB data indicates that growth of international online retail purchases by Australian residents has been trending downwards for at least the last 3 years.***
- ***iii) All in all, it is difficult to see that the growth of online retail sales has had any major negative impact on the Australian retail industry as a whole.***
  - ***Although this is not to say that some sectors of the retail industry or some individual retailers might not have felt the impacts of growing online sales.***

[9] To correct for the apparent difference in scope of coverage between the NAB survey and the ABS survey the NAB number was scaled back to $2.6 billion, being 62.5% of $4.1 billion. This corresponds with the fact that $8.0 billion is 62.5% of $16.9 billion.)

2.6 Entries and Exits of Retail Businesses

2.6.1 Discussion of the Data

There are a number of comments that need to be made in relation to Dr Sands' analysis of the entry and exit data for the Australian retail industry over the period 2010/11 to 2013/14. In particular I have concerns over the correctness of his interpretation of the data, the appropriateness of his analysis and, consequently, over the correctness of his conclusions. It is also a matter of some concern that Dr Sands' analysis suggests that he lacks a proper understanding and appreciation of the nature of the retail industry.

As a starting point to my comments I note that Dr Sands refers to "openings" and "closings", rather than to entries and exits. While in some ways a minor point, it is nevertheless relevant to note that these terms are not entirely appropriate. The ABS has chosen "entries" and "exits" as the terminology for this series of data for specific reasons. While it is not necessary in this report for me to elaborate upon these reasons it is, I think, appropriate for me to expand on the nature of 'entries' and 'exits' in the count of Australian businesses by the ABS. ***In particular, it needs to be noted that the exit of a business from the ABS count does not necessarily mean that the bushiness has 'failed'.*** Instead, businesses can exit from the ABS count of businesses for a number of reasons. For example, the owner of the business may have decided to retire, or he/she may have decided to close the business for personal reasons, or he/she may have died. Additionally, a business may have merged with, or been taken over by another business. Or the business may have been sold to a new owner, who then re-registers the business for GST purposes, as there will often be a need to do. And there are still other possible reasons why a business may be shown as an 'exit' in the ABS data other than because it failed.

Table 4 shows ABS data for the entry and exit of businesses in respect of the Retail Trade industry. It is essentially the same data as that included in Dr Sands' report, but over a longer time frame.

This data needs to be interpreted with considerable caution, as there has been two significant 'breaks' in the series over time. The first 'break' (being the terminology used by the ABS) occurred in 2007/08, the result of the Federal government lifting the GST threshold to $75,000 per annum for businesses (from $50,000). This impacted the series as the ABS count of Australian businesses includes only 'actively trading businesses' *and businesses are judged to be actively trading only if they are submitting GST remittances.* Consequently the change in the GST threshold caused a substantial drop in the number of businesses included in the count, as many

businesses with turnover between $50,000 and $75,000 withdrew from collecting and remitting GST.

It seems likely that this change also affected the count of exits in 2007/08 and 2008/09, as some businesses lagged in their decision to stop charging and remitting GST.

There were also other changes to this data series around this time. But the impact of the change in the GST threshold appears to be the major reason for the sharp change in the data.[10]

Nevertheless, it is unlikely that these changes in data collection were entirely responsible for the sharp rise in business exits from the retail industry in 2007/08 and 2008/09. Instead it is likely that the advent of the GFC had a major impact on some retailers' fortunes.

The second major break in this data series occurred in 2010/11, when the ABS changed its definition of a "dormant business". Previously a business was considered to become dormant (and hence included in the statistics as an 'exit') once it failed to submit a GST return in 5 consecutive quarters. Under the new definition this period was extended to 3 years. (A reflection of the fact that the Federal Government changed the rules, requiring small businesses to submit their GST forms only once a year, rather than quarterly.)

This change in the ABS's definition had two major impacts on the data series. First, it meant a jump in entries in 2010/11, as businesses which had previously been excluded from the count were reinstated. Second, it meant a much higher level of exits in 2012/13, as under the old definition many of these businesses would have "exited" in 2010/11 and 2011/12.

All of this puts a different complexion on Dr Sands' analysis. In particular it means:

- ***that there was not necessarily an increase in retail business 'closures' over the period 2010/11 to 2012/13; and***
- ***that it is not altogether clear that exits would have exceeded entries across all of this period if the old definitions applied.***

Nevertheless, to be fair, it is likely that there were a higher number of business exits across the period 2010/11 to 2102/13 than in earlier periods, given the on-going impacts of the GFC and the slower growth of the Australian economy which has been evident since the GFC.

[10] I did contact the ABS to get a better indication of the impact of these changes, but at the time the ABS was unable to provide further information. (ie more in-depth research was required)

Of course, to some extent at least, the higher level of exits in this period would simply be characterised as the downside of the strong level of new entries (and expansion of existing retail businesses) during the boom period leading up to 2008.

2.6.2 Nature of the Retail Industry

To properly understand the high level of entries and exits to/from the retail industry and indeed to properly understand why many retailers always feel that trading conditions are difficult, it is essential to understand the nature of the retail industry.

The retail industry is what is known in economics (and strategic management) as a "fragmented industry", being an industry with a large number of small and medium size competitors. Characteristics of such an industry typically include limited opportunity to realise economies of scale, limited differentiation of product and, importantly, low entry barriers and generally low exit barriers. ***The outcome of such characteristics is that competition is almost always invariably intense.***

The reality is that no matter the state of the economy there are invariably always people who perceive opportunities in the retail sector. Low barriers to entry (or expansion) mean that it is relatively easy for people to act on these perceptions, to start (or expand) a retail business. In turn, this ensures continuing intense competition in the retail sector which, also in turn, brings about a relatively high exit rate as businesses fail to deal with this intense competition. Thus the level of entries and exits is much higher in the retail sector than in many other industries, namely those which do not exhibit such a high degree of 'fragmentation' and hence do not exhibit the same characteristics of limited differentiation of product and low entry and exit barriers.

In short, the nature of the retail industry is such that there will *always* be a relatively high level of entries and exits of businesses occurring, *no matter the state of the economy or of other factors*.

Furthermore, the nature of the retail industry explains why it is that no matter what economic conditions exist, good or bad, there will always be a significant number of retailers who are struggling to make a profit and an even greater number who perceive trading conditions to 'be difficult.' It is simply the nature of the industry.

Table 4: Counts of Businesses, Retail Trade, Australia

	Businesses at start of year	Entries	Exits	Change across the year	Entry Rate(1)	Exit Rate(1)
	no.	no.	no.	no.	%	%
2003/04	211,284	37,570	33,790	3,780	17.8	16.0
2004/05	215,064	37,554	35,658	1,896	17.5	16.6
2005/06	216,960	34,401	33,677	724	15.9	15.5
2006/07	217,684	35,876	34,252	1,624	16.5	15.7
	break in series					
2007/08	145,609*	20,367*	23,527*	-3,060*	14.0*	16.1*
2008/09	142,609	19,592	22,522*	-2,930*	13.7	15.8*
2009/10	139,679	23,669	19,667	4002	17.0	14.1
Old 2010/11	143,681	20,919	20,921	-2	14.6	14.6
	break in series					
New 2010/11	143,681	21,443*	20,969*	474*	14.9*	14.6*
2011/12	144,368	19,755	20,848*	-1,093*	13.7	14.4*
2012/13	143,275	14,751	22,429*	-7,678*	10.3	15.7*
2013/14	135,597	17,637	18,765	-1,128	13.0	13.8

(1) Entry and exit rates are calculated as a percentage of the number of businesses operating at the start of the year.

* These results are directly impacted by the cause of the break in the series and hence are not comparable with earlier numbers. These results need to be interpreted with caution – refer to discussion in text.

Source: ABS cat. no. 8165.0 *Counts of Australian Businesses, including Entries and Exits*

Table 5

Retail Trade, percentage of Businesses Recording an Operating Profit or Loss(1)

	Made a Profit*	Made a Loss*
	%	%
2007/08	72.6	26.2
2008/09	73.6	24.9
2009/10	70.3	28.4
2010/11	68.6	30.9
2011/12	70.4	27.6
2012/13	72.5	26.2
2013/14	75.2	24.3

(1) 'Retail Trade' according to ANZSIC classification

* The percentage of firms making a profit and making a loss will generally not add to 100 because of firms who "broke even" in the period (excluded from this table) and some small degree of rounding error.

Source: ABS cat. no. 8155.*0 Australian Industry*

3. Conclusion

The purpose of this report was to provide a critique of Part One of the report by Dr Sands of the ACRS, Monash University, entitled "Retail Award Research" (referred to in this report as 'the Sands Report'), which had been prepared as input into the Fair Work Commission's 2015 review of the General Retail Industry Award 2010.

Part One of the Sands report attempts to provide an assessment of the current state of the retail industry. It does so very badly. The conclusions of the report are based on several serious misinterpretations of the data, as well as incorrect usage of data, leading Dr Sands to reach conclusions that, to put it bluntly, are wrong.

I do not consider this to be a matter of opinion. Wrong is wrong.

The nearest Dr Sands comes to an overall conclusion of his analysis at Part One of his report is the following sentence from his Executive Summary:

"The slowdown in retail sales in real prices, decline in retail firm operating profitability, increase in retail business closures and aggregate retail hours worked not recovering to 2007 peak, indicates that despite some improvement since 2012, the retail industry continues to struggle"

However, I contend that such a conclusion is not supported by the facts. In short, it is wrong to describe the Australian the retail industry as currently being in a situation where it '... continues to struggle'. To the contrary, the vast majority of the evidence points to the Australian retail industry currently being in a state which at the very least can be described as 'healthy', if not actually strong.

The reality is that Dr Sands' report exhibits a lack of expertise in the area of economic analysis, is error-ridden in its analysis and data interpretation, and lacks a proper degree of comprehensiveness.

Contrary to the findings of Dr Sands, the analysis presented in this report shows that:

- ***retail sales*** *have* continued to grow in real terms over the period 2010 to 2014/15 and have done so in a fairly *solid* manner *(refer Figure 3 and Table 1);*
  - furthermore, the rate of growth of retail sales has improved since 2012/13, being up 3.1% in real terms in 2013/14 and a further 3.3% in 2014/15 sales, which equates to very solid growth.
- total ***profits*** across the retail industry as a whole have remained at a strong *level* over recent years, notwithstanding that the *rate of growth* in total profits has been relatively slow across this period (eg compared to the period 2001 to 2008) *(refer Figures 6 and 7)*

- to put it in perspective it can be noted that by 2012/13 total profits for the retail sector as a whole had moved back above the record level reached at the end of the 'boom period' (ie around 2008) following almost 15 years of sustained strong growth of the Australian economy, and have remained above this level since then.

- ***profit margins*** for the retail industry have remained at strong levels in the period 2010 to now, around historical highs *(refer Figure 8)*
- the ***total wages bill*** of the retail industry has grown at a slightly higher rate than the growth in sales in the period since 2010, but not to the extent of damaging profitability
  - the main explanation for this is that there has continued to be strong growth in labour productivity in the retail trade industry in this period *(refer Figure 12)*
- the number of ***persons employed*** in the retail industry has continued to climb in recent years, with the number of persons employed on average across the year ended May 2015 up 3.6 per cent on the number of persons employed on average across the year ended May 2010
  - admittedly this is not a strong rate of growth of employment, but nor is it negative growth.
  - it is also important to recognise that employment growth is not necessarily the best indicator of the health of an industry. Profitability and business survival rates are better indicators.
- ***online retail purchases*** from non-Australian-resident retailers remain a very small proportion of total 'general retail' sales, perhaps as little as 1.1%. As such, it cannot be claimed that growth in these sales has had a significant negative impact on the local retailing industry.
- the high level of ***'exits'*** from the retail industry in recent years is not a matter of major concern. It does not point to a sharp drop in the health or viability of the Australian retail industry. This is because:

  iv) not all "exits" represent business failures

  v) the data has been significantly skewed by changes in definitions in the ABS's data collection for this series, so that the number of 'exits' have been significantly skewed upwards in recent years; and

  vi) the nature of the retail industry is such that there will *always* be a high level of entries and exits *no matter what the overall state of the economy or of business operating conditions*.

One area of concern identified by Dr Sands – and confirmed by the analysis undertaken for this report – is the continued decline in the number of young people employed in the Australian retail industry. The number of persons aged 15 to 19 years employed in the retail industry has continued to decline over recent years, even as the number of persons in other age groups employed in the retail industry has picked up (refer Figure 18).

The reason for this trend is unclear and to my mind is a matter warranting further research.

It seems to me, however, that the continued decline in employment of persons aged 15 to 19 years cannot be taken as an indicator that the retail industry "...continues to struggle"; not when employment among other age groups has increased.

Overall, the conclusion of the analysis undertaken for this report is that there is little to no evidence to suggest that the retail industry at the current time can properly be described as "continuing to struggle". To the contrary, the overall situation of the Australian retail industry is better described as being 'healthy', if not actually verging on being "strong". Certainly, real retail sales growth of 3.3%, as occurred across 2014/15, back up by total profits across the industry remaining around record levels, together with retail profit margins being remaining around their highest level in the past fifteen years, indicates to my mind at least that the Australian retail industry is in a very healthy state.

Appendices

Appendix A

Summary CV, Mr Kevin Kirchner

Kevin Kirchner

Principal, Fulcrum Economics Australia

(ABN 70 395 642 253)

About Fulcrum Economics Australia

Fulcrum Economics Australia (FEA) is a boutique consulting business, offering expertise in economic analysis and strategic advice.

Fulcrum Economics Australia provides consulting, advisory, research and analysis in applied economics. Specific areas of experience and expertise include industry analysis for business management purposes, development of business plans and formulation of business strategy, economic and business forecasting, developing and evaluating public policy issues and initiatives, and provision of expert economic advice in general.

FEA's services are based primarily on the economic expertise, high level analytical skills, and experience of the Principal, Kevin Kirchner.

Contact Details

kevinkirchner@iprimus.com.au
ph. (+61 8) 8264 0718
ph. (+ 61) 0410 347 615
(Location: Adelaide, South Australia)

Professional Expertise and Experience

Kevin Kirchner is a highly experienced professional economist, whose career history includes positions in the Commonwealth Public Service, two significant economic consulting firms, a major financial institution and, most recently, as a tenured academic.

Career History

2002 – current: Principal, Fulcrum Economics Australia

2002 – 2014: Lecturer, Flinders Business School, Flinders University

Areas of specialisation: economics, strategic management, entrepreneurship.

1994 – 2002: Senior Economist, South Australian Centre for Economic Studies (SACES)

SACES is an economics-focused consulting operation based within Adelaide University. It provides high level consultancy services to both public and private sector clients.

1986 – 1994: Economist and then Senior Economist, State Bank of South Australia

As a member of the Economics team of the bank: provided economic and industry research, analysis and advice in support of the business activities of the bank. During this period, member of two key management committees:

* Asset and Liability Management Committee (ALMAC), 1989 - 1994
* Liability Management Committee, Group Asset Management Division (1992 – 1994)

1984 – 1986: Economist, BIS-Shrapnel, Sydney

Economic consulting firm, specialising in analysis relating to the commercial, housing and engineering construction industries; and associated business advisory.

1980 – 1983: Graduate Entry and subsequent positions in the Commonwealth Public Service

Department of Housing and Construction, Department of Science and Technology, Bureau of Transport Economics; based in Canberra.

Qualifications

Bachelor of Economics
University of Adelaide

Graduate Diploma in Economics
Australian National University

Master of Business Administration
Australian Graduate School of Management,
University of New South Wales

As at August 2015

Appendix B

Letter of Engagement

28 July 2015

Mr Kevin Kirchner

Principal **Confidential/Client Legal Privilege Applies**

Fulcrum Economics Australia

By email: kevinkirchner@iprimus.com.au

Dear Mr Kirchner

Four Yearly Review of Modern Awards – Penalty Rates AM2014/305

We act on behalf of the Shop, Distributive and Allied Employees' Association (**SDA**). The SDA is an organisation of employees registered under the *Fair Work (Registered Organisations) Act 2009* (Cth) and has as members persons employed in the retail industry throughout Australia.

You are engaged by the SDA to provide your expert opinion in relation to the *Retail Award Research* undertaken by Dr Sean Sands (**Sands Report**).

Background Information

In accordance with s 156 of the *Fair Work Act 2009* (Cth), the Fair Work Commission (**Commission**) is required to conduct a 4 yearly review of modern awards. As part of that review, the Commission has determined to convene a Full Bench to consider proposals to alter penalty rates in various identified awards.

The SDA has an interest in a number of the awards to be considered by the Full Bench in that part of the 4 yearly review relating to penalty rates and to that extent intends to participate in the review proceedings before the Commission.

Specifically, the SDA has an interest in the *General Retail Industry Award 2010*, the *Fast Food Industry Award 2010,* the *Hair and Beauty Industry Award 2010* and the *Pharmacy Industry Award 2010.*

Expert Opinion

Please provide a written report containing your opinion of Part One of the Sands Report.

In providing your opinion, please direct your attention to:

(c) the statement in the Executive Summary of the Sands Report that "*the slowdown in retail sales in real prices, decline in retail firm operating profitability, increase in retail business closures and aggregate retail hours worked not recovering to 2007 peak, indicates that despite some improvement since 2012, the retail industry continues to struggle*"; and

(d) the nature and extent of any changes in economic conditions in the retail industry between 2010 and 2014.

In preparing your report, please ensure that you have considered and addressed the matters set out in the Federal Court Practice Note enclosed,[11] in particular, Guidelines 1.1 to 1.3 and 2.5 to 2.7.

Documents

We have enclosed the Sands Report.

Form of Your Report

Please address your report to the Fair Work Commission and ensure that your report contains the following:

a. a brief summary of your opinion or opinions at the beginning of the report;

b. a glossary of any specialised terminology;

c. references to any literature or other materials cited in support of your opinions. Please use a uniform citation method throughout the report. If you use parenthetical referencing (Chicago-style citation), please provide pinpoint citations where applicable;

d. a bibliography;

e. numbered paragraphs, page numbers and headings where appropriate;

f. margins of at least 2.5 centimetres and line spacing of at least 1.5 points with 12 points between paragraphs.

Please attach to your report:

g. a detailed curriculum vitae, setting out the study, training, and experience that establishes your expertise in relation to the issues raised by these instructions; and

h. this letter of instruction.

At the conclusion of your report, please sign it and include a declaration to the following effect:

I have made all the inquiries that I believe are desirable and appropriate and that no matters of significance that I regard as relevant have, to my knowledge, been withheld from the Commission.

Timing and Communications

Your report is due to be filed in the Commission on **24 August 2015**.

It is likely that you will be required to give oral evidence before the Commission in relation to your report. Hearings are scheduled to occur in the period from **8-25 September 2015**. Closer to that time,

[11] Federal Court of Australia - *Practice Note CM 7* 'Witnesses in Proceedings in the Federal Court of Australia' 3 June 2013.

we will confirm the specific date upon which you will be required to attend at the Commission and we will make arrangements for that attendance.

Please note that all communications between you, the SDA and its legal representatives can, on request, be provided to the employer organisations and the Commission. This includes any draft of your report, including your working notes.

Please contact Mr Dominic Macken on (03) 9614 4899 if you have any questions in relation to the above.

Yours sincerely,

A. J. MACKEN & CO.

Appendix C

Compatibility of the Data

Across its various data collections the ABS uses two definitions of "Retail Trade". This appendix briefly explains these two definitions and considers the differences between them and that of "General Retail" as used in the 'General Retail industry Award 2010'; and, in turn, addresses the question of the extent to which the various ABS data series are compatible with analysing issues concerning the 'General Retail Industry'.

The first definition of Retail Trade used by the ABS applies only to data collected for the 8501.0 *Retail Trade* series. This series is concerned with measuring retail sales. The main difference between the coverage of this series and the coverage of the GRIA2010 is that the ABS series includes sales by 'Cafes, Restaurants and Takeaway Food', whereas this sector is not part of the General Retail industry as per the GRIA2010. However, this does not present a problem in undertaking analysis relating to "General Retail", as sales by 'cafes, restaurants and takeaway food' is a separate category in the 8501.0 series and hence can easily be excluded from the rest of the retail sales data.

There are a couple of other minor differences between the coverage of the 8501.0 series and that of the GRIA2010, but they are so minor that their inclusion in the ABS data is very unlikely to skew the results of any analysis related to the GRIA2010.

For all other data collections besides the 8501.0 series the definition the ABS uses for the Retail Trade industry is the ANZSIC definition – that is, the Australian and New Zealand Standard Industry Classification. The main difference between the ANZSIC definition of the Retail Trade industry and "General Retail" is that the ANZSIC definition includes *motor vehicle retailing*, *motor vehicle parts and tyre retailing*, and *fuel retailing*. Unfortunately, the ABS does not identify these categories separately in the various data series that use this definition. These data series include those for employment, industry profits and industry value added. Consequently, in using this data to analyse trends or other aspects of the "General Retail" industry it is necessary to include these sectors. However, while it is the case that these sectors are not an insignificant part of the Retail Trade industry it is nevertheless unlikely that their inclusion would skew the results of most analysis related to issues concerning the "General Retail" industry. In particular, it is unlikely that their inclusion would have in any way skewed the results of the type of analysis undertaken in this report.

Glossary

ANZSIC

Australian and New Zealand Standard Industry Classification

Barriers to entry

Barriers to entry are economic or technical factors which prevent or make it difficult for new firms to enter a market and compete successfully with established firms. This can include such factors as existing firms having an absolute cost advantage, because they patent rights or have exclusive access to lower cost inputs, or because there are significant economies of scale in the industry. Other barriers to entry can include the need for licences, access to locations, or strong brand names.

Barriers to exit

Barriers to exit exist when it is costly for a business to exit an industry. For example, a firm may have long term contracts with employees or suppliers or a long term lease on a building which still need to be met whether or not the business is operating. When exit costs are high a firm should continue to operate for as long as it is attracting sufficient revenue to at least cover its fixed costs, for as long as it is covering its fixed costs it will be making less of a loss than if it were to shut its doors.

Economies of Scale

Economies of scale are factors which cause the average cost of producing a good to fall as output of that good (meaning the scale of operations) increases. Thus, for example, if a firm is able to double its output without its total costs doubling (so that the average costs of production per unit of output falls) then the firm is said to be realising economies of scale. There are several possible sources of economies of scale and in some industries economies of scale can be very significant. In the Australian retail sector Coles and Woolworths are examples of two firms whose business model is based to a very large extent on realising economies of scale.

Gross Domestic Product

Gross Domestic Product (GDP) is a measure of the value of all goods and services produced within an economy within a certain time period. Note that only 'final goods' (ie those which will be consumed or exported) are included in the measure, so as to avoid double counting.

Real Gross Domestic Product is Gross Domestic Product adjusted for changes in prices. Real Gross Domestic Product provides a truer measure of growth in economic activity and hence a truer measure of growth in the well being of society (notwithstanding the short-comings of GDP for this purpose). Thus, for example, if the value of production has increased by 10% from one year to the next, but prices of what has been produced have increased by 8% then the reality is the *quantity* of goods and services produced has actually only increased by 2%. It is (normally) the amount of what we produce that determines our living standards, not the prices we pay for it. (The exception is where there has been a change in the Terms of Trade).

Monopolistic competition

Monopolistic competition describes an industry in which there are many firms each producing products that are close substitutes, but where consumers are still able to differentiate in some way between the products of different firms – for example, because of different features of the product (eg mobile phones), different perceptions of quality, differences in appearance, differences in perceptions of durability, differences in actual durability, differences in quality of service provided, location of provider, ease of parking, etc

Consequently, some consumers will prefer the product of one producer (eg a producer of retail services) to those of competitors, sufficient to exhibit an amount of loyalty to the product when the price increases. This means that each firm has a small amount of monopoly power (≡ market power) and is thus not a price-taker.

Oligopoly

An oligopoly is a market which is dominated by a few large firms. Invariably each firm in such a market has some degree of market power.

Moving annual average

When data is available on a monthly or quarterly basis an 'annual average' is calculated by taking the average of 12 consecutive months or 4 consecutive quarters. A 'moving annual average' series is simply a moving progression of this sum, dropping out the earliest month or quarter each time and adding in the next month or quarter in the sequence.

Moving annual total

When data is available on a monthly or quarterly basis an 'annual total' is calculated by simply adding 12 consecutive months or 4 consecutive quarters of data. A 'moving annual total' series is simply a moving progression of this sum, dropping out the earliest month or quarter each time and adding in the next month of quarter in the sequence.

Seasonally Adjusted data

Seasonally adjusted data is time series data where fluctuations that exhibit a regular pattern from year to year have been eliminated. For example, retail sales invariably rise strongly in the leadup to Christmas. By offsetting this rise in the statistics, to give seasonally adjusted data, a clearer picture of the underlying trend is obtained.

'year on year' percentage change

'year on year' growth – also sometimes referred to as 'year average' growth - is calculated by summing the data over a year (whether monthly data or quarterly data) and determining the percentage change relative to the same sum for the previous 12 months or four quarters. Often this is also referred to as 'annual growth'. However, note that 'year to' growth is *also* often referred to as 'annual growth'.

'year to' percentage change

'year to growth' – also referred to as 'through the year' growth – refers to the percentage change between the data for one month or quarter and the data for the same month or quarter a year earlier. Often this is also referred to as 'annual growth'. However, note that 'year on year' growth is *also* often referred to as 'annual growth'.