

Sales of Cigarettes and Tobacco Products by Type of Retail Business

An analysis of the significance of sales of cigarettes and tobacco products to tobacco retailers in Australia



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Executive Summary

1 Introduction

The two objectives of this report are to provide:

- Retailers of all sizes, retail associations and Governments with an evaluation of and an insight into the significance of cigarettes and tobacco products to retailers in Australia; and
- A summation of the key issues that are of current concern to retailers of cigarettes and tobacco products.

This report updates the PricewaterhouseCoopers' (PwC) March 1999 report titled *The Significance of Cigarettes and Tobacco Products to Retailers: An analysis of retail sales*. The sales and margins data for this report were obtained from a combination of information received from industry, Australian Bureau of Statistics (ABS) publications, retail industry reports and research organisations with an interest in the retail industry.

2 Facts on Significance of Tobacco and Cigarettes to Retailers – Key Observations on Changes

The key findings of this report are:

- Retail sales of tobacco and cigarettes were \$9.31 billion in 2004, representing a 32 per cent rise from \$7.06 billion in 1997-98.¹
- Sales of tobacco and cigarettes accounted for 4.7 per cent of total spending on all retail sales in 2004, representing a reduction from 5 per cent in 1997-98;
- Cigarettes and tobacco products were sold in more than 35,000 different outlets across Australia in 2004, which represents a reduction from an estimated 40,000 outlets in 1997-98. There is a general trend of a reduction in the number of route trade and mixed business outlets², as they lose market share to supermarkets and convenience stores.³ Partly offsetting this reduction has been strong growth in the number of convenience stores, with these now accounting for 13 per cent of sales of cigarettes and tobacco products (up from 5 per cent in 1997-98);⁴
- The revenue and gross margins generated by sales of cigarettes and tobacco products comprise a major part of business for many Australian retailers, particularly for small mixed businesses and tobacconists. These goods also form a significant proportion of total sales for most major grocery retailers. Margins in 2004 vary considerably between different types of retailer, from 6 and 8 per cent for tobacconists and supermarkets to 30 per cent for convenience stores.

¹ The bulk of this rise has been driven by sales not previously captured by Scanned Retail Sales Data, the introduction of the GST and the escalation of excise taxation rates by the Consumer Price Index (CPI).

² Retailers are considered to be in route trade when they are located outside shopping malls and similar centres; they are typically located on main roads or 'high streets' either in strip shopping precincts or on more prominent corners.

³ *Route Trade in Australia, 2004 to 2006*, BIS Shrapnel, July 2004

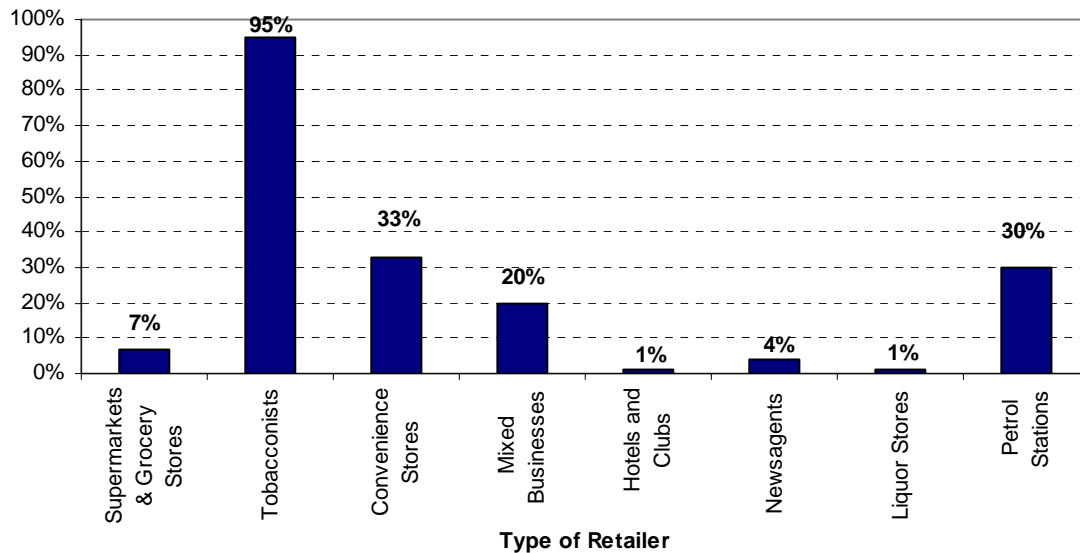
⁴ The number of outlets selling tobacco and cigarettes products is a PwC estimate derived from outlets serviced directly by manufacturers plus estimated outlets purchasing via wholesalers.

Overall, the average gross margin earned by retailers has improved from 7 per cent in 1997-98 to around 13 per cent in 2004;

- For other retail profitability measures, such as the floor space utilised to sales ratio, cigarettes and tobacco products are generally strong performers. Tobacconists aside, cigarettes and tobacco typically account for a minor proportion of floor space (say 2 to 5 per cent) whilst for a number of retailer generating a far larger proportion of total sales (see Figure E.1).
- Sales of cigarettes and tobacco products in 2004 by supermarkets, grocery stores and convenience stores represented 64 per cent of total sales of these goods, a rise from 40 per cent in 1997-98; and
- Retailers of cigarettes and tobacco provide employment for over 0.5 million Australians.

Figure E.1 below illustrates the proportion of total sales represented by cigarettes and tobacco products for each type of retail business.

Figure E.1: Cigarettes & tobacco products as a proportion of Total Sales, 2004



Notes: * Petrol Station Total Sales excludes petrol sales

Tobacconists, as would be expected, are highly dependent on sales of cigarettes and tobacco products. Convenience stores also are very reliant on sales of cigarettes and tobacco products, with these goods typically accounting for more than 33 per cent of total sales. Sales of cigarettes and tobacco products account for 7 per cent of total sales in supermarkets and major grocery stores, although this result is moderated by the substantial scale and diversity of sales of food and groceries made by this type of retailer.

Table E.1 summarises the key findings of this report in relation to the extent of cigarettes and tobacco sales and gross margins by type of retail business.

Table E.1: Cigarettes and Tobacco Products – Key Characteristics, 2004

Type of retail business	Total Australian Retail Sales of cigarettes and tobacco (incl GST) (\$ mill)	Proportion of cigarettes & tobacco products sold by retailer type	Estimated gross margin from sales of cigarettes and tobacco products (\$ mill)	Estimated average gross margin per packet
Supermarkets & Grocery Stores	4,478	51%	382	8%
Tobacconists	1,800	19%	108	6%
Convenience Stores	1,203	13%	360	30%
Mixed Businesses	875	9%	184	21%
Hotels and Clubs	244	3%	56	23%
Newsagents	171	2%	27	16%
Liquor Stores	151	2%	30	20%
Petrol Stations	92	1%	18	20%
Other Retailers	negligible	-	-	-
Total	9,314	100%	1,165	13% (average)

3 Facts on significance of cigarettes and tobacco products for different types of retailer – Key observations on changes

In relation to profitability and viability, the key findings of this report are:

- Cigarettes and tobacco products contribute significantly to the gross margin (retail price less costs incurred by the retailer) of a large proportion of retailers and this contribution is critical to their profitability and long-term sustainability and viability;
- Each type of retail business targets different customer segments by varying prices and the service level or turnaround time;
- Convenience stores, many mixed businesses and vending machines located in hotels and clubs earn the highest gross margins, with a focus on single packet sales and a fast turnaround time;
- Tobacconists, on the other hand, generally target higher volumes while recording the lowest average gross margin of six per cent: these lower margins are generated through a focus on discounted carton sales;
- Supermarkets and grocery stores achieve the highest sales volumes by attracting more customers; while cigarettes and tobacco products represent only seven per cent of their total sales, the magnitude of their overall sales generates a substantial aggregate margin for these stores;

- The importance of sales of cigarettes and tobacco products to convenience stores is highlighted by the estimated gross margin generated from these sales being \$360 million (second only to the gross margin generated by supermarkets and grocery stores) out of total turnover from these sales of \$1,203 million;
- Research indicates that the number of tobacconists and mixed businesses located in areas of route shopping trade are in decline.⁵ This is partly due to smaller business being absorbed by or amalgamated into larger retail groups; and
- Overall, these results demonstrate that any changes in the operating environment that lead to a reduction in revenue generated through sales of cigarettes and tobacco products is likely to have a major adverse impact on the viability of many of these retailers, particularly tobacconists, convenience stores and many mixed businesses. Retailers who seek to respond to legislative changes by removing cigarettes and tobacco products from their product range also will experience reductions in gross revenue, margins and, hence, profitability.

4 Key issues and questions for consideration for retailers and commercial trade - tobacco and cigarettes

Consultations with tobacco retail industry representatives and other stakeholders (see list of those consulted at Appendix 1) identified some important issues that are of concern to tobacco retailers. The most significant concerns relate to compliance with the increasing policy restrictions and regulation and, in particular, the introduction of restrictions on tobacco displays in stores. The key observations and questions raised by retailers about these important matters are summarised in **Table E.2** below.

Table E.2: Key observations and questions raised by retailers in relation to sales of cigarettes and tobacco

Retailer Observations	Questions raised by Retailers
Increasing display restrictions and sale regulation is adding costs and may constrain sales	<ul style="list-style-type: none"> • Why are retailers being targeted rather than resolving the issue at its source by targeting the incidence of smoking particularly amongst younger people? • How are smaller retailers supposed to fund the capital costs of complying with display restrictions (estimated at \$50,000 per counter)? • Will these changes further erode the competitive position of smaller business, especially those outside major shopping centres, as some customers may shift their purchasing patterns towards retailers where availability is more certain? • Will display restrictions increase the risk of assaults on retail staff who will be required to take their eyes off customers to retrieve cigarettes from storage?
The potential impacts of new regulations on retailers have not been properly evaluated. Retailers are not being fully consulted to ensure new regulations are workable.	<ul style="list-style-type: none"> • How will the new display regulations impact on my financial viability? • How will continued regulation affect my employees?

⁵ *Route Trade in Australia, 2004 to 2006*, BIS Shrapnel, July 2004.

Retailer Observations	Questions raised by Retailers
The new regulations are not only likely to impact adversely on cigarette sales but they will also put at risk critical ancillary sales, as customers who purchase cigarettes also typically buy other goods such as bread and milk. ⁶	<ul style="list-style-type: none"> • If restrictions on cigarette sales result in the loss of such customers - what will be the full impact when ancillary sales are also considered?
Smaller retailers perceive that there is a potential inconsistency between some Government policies which aim to support small business on one hand while other Government reforms seek to restrict sales of cigarettes and tobacco products on the other, which they see as likely to reduce viability.	<ul style="list-style-type: none"> • Can governments specifically consider likely impacts on smaller businesses when developing new regulations?
The growth of taxes on tobacco products, have led to an increase in demand for illegal tobacco ('chop chop') which is adversely impacting on legal sales	<ul style="list-style-type: none"> • What is the Commonwealth Government's strategy for reducing or eliminating illegal tobacco?
If sales of cigarettes and tobacco as well as ancillary products are adversely impacted there is a potential need to adjust employment levels	<ul style="list-style-type: none"> • What evaluations have governments completed on the potential adverse employment impacts of the various proposed changes?

Overall, many of the smaller tobacco and cigarette retailers have a number of concerns about the impact of greater regulation and the increasing availability of illegal tobacco on their profitability and ability to maintain current employment levels.

A critical conclusion from consultations with a broad cross section of retailers of cigarettes and tobacco products is that the impact on retailers of complying with new regulations is often not evaluated in a transparent and realistic manner.

⁶ The US Association of Convenience Stores indicates that a customer purchase which includes cigarettes has an average of twice the total dollar value of an average sale which does not include cigarettes. See: http://www.nacsonline.com/NR/exeres/00005c1f1qinhgjwkkccdhgy/NewsPosting.asp?NRMODE=Published&NRORIGINALURL=%2fNACS%2fNews%2fDaily_News_Archives%2fOctober2003%2fnd1012033%2ehtm&NRNODEGUID=%7b53EEBB00-8130-4969-AFA0-B095D18B7D9F%7d&NRQUERYTERMINATOR=1&cookie%5Ftest=1

1. Introduction

The primary focus of this report is to undertake an analysis of the significance of sales of cigarettes and tobacco products to Australian retailers during 2004. This project updates a study undertaken by PricewaterhouseCoopers, *The Significance of Cigarettes and Tobacco Products to Retailers: An analysis of retail sales*, prepared in March 1999.

This study also focuses on ascertaining those issues in particular that impact on retailers of cigarettes and tobacco products. Some of the main issues identified are:

- Policy approach to small business;
- New regulations on tobacco displays;
- Impact of sales of illegal tobacco; and
- Costs of insurance and potential licensing of tobacco retailers.

Detailed information on the tobacco and retailing industry has been obtained from a number of sources including the tobacco industry, retail industry associations and individual retailers. The participation of these organisations in consultations, and the provision of submissions and reports, was invaluable. These sources of information were supplemented by desktop research, and statistics published by the Australian Bureau of Statistics (ABS) and other organisations.

During the conduct of research for this report, it became apparent that the report prepared by PricewaterhouseCoopers (PwC) in 1999 has been used by various retailing interests and other organisations as a key source of data on this subject. This demonstrates the lack of comprehensive, national information on this important issue.

The remainder of this report is structured as follows:

- **Chapter 2** provides an overview of the approach and methodology used;
- **Chapter 3** profiles the structure of the tobacco retail industry and the nine types of retailer examined in the study;
- **Chapter 4** provides an overview of the performance of each type of retail business in relation to cigarette and tobacco sales; and
- **Chapter 5** identifies the main issues that are affecting the industry.

2. Methodology

The objective of this report is to analyse the significance of sales of cigarettes and tobacco products to retailers operating in Australia. Of particular interest is the relative importance of these sales to the large number of small retailers in Australia.

Types of Retailers

An important issue with any analysis of retail industry is to have a clear understanding of the types of retailers being evaluated. This report broadly follows the categorisation used by Australian Bureau of Statistics (ABS) and divides retailers of cigarettes and tobacco products into the following types:

- supermarkets and grocery stores;
- mixed businesses;
- tobacconists;
- newsagents;
- convenience stores;
- petrol stations;
- hotels and clubs;
- liquor stores; and
- other retailers.

This classification framework enables some useful comparisons to be made between the results of the analysis conducted in 1999 and that contained in this report. Further detail on each type of retail business is provided in Section 3.

Data sources and issues

A number of data sources were used to provide the necessary information for this report. These sources included:

- industry consultations, that provided qualitative information as well as quantitative information such as reports and submissions prepared by different industry groupings;
- ABS data including the Census of Retail Establishments 1999, the Survey of Retail Industry 1998-99 and the Household Expenditure Survey 1998-99;
- discussions with specialised research organisations; and
- desktop review of relevant information within PwC.

Every attempt has been made to gather data from all relevant sources and to ensure that the data collected is consistent and as accurate as possible. As with all projects of this type, there are some gaps in data availability, giving rise to a need for PwC to make estimates. Moreover, within some of the types of retailers considered in this report, there can be a wide variety in operating characteristics applying to different stores, across such parameters as product range, workforce size, opening hours, availability of capital funds and sources of supply.

As with the analysis undertaken in 1999, there is still a lack of aggregated industry data dealing with the operations of retailers in Australia. An exception to this situation is the convenience stores. The substantial growth in convenience stores over recent years has meant that it is now a far more significant component of tobacco retailing. The relevant industry association has sought to develop a detailed profile of convenience stores and this provides an excellent analysis into the characteristics of convenience stores and of the reasons why people choose to shop in these stores.

Irrespective of these issues, this report presents a valuable insight into the operations of retail industry in Australia and, in particular, of the continuing significance of sales of cigarettes and tobacco products to many retailers.

3. Structure of the tobacco industry

Types of Retailer – classifications

The framework used in this report to analyse retailers who sell cigarettes and tobacco products classifies retailers into nine types. **Table 3.1** lists examples of the types of retail businesses, their characteristics and provides some examples of each type.

Table 3.1: Types of Retail Businesses

Type of retail business	Characteristic	Examples of retailers
Supermarkets and Grocery Stores	Major national and regional grocery chain retailers and a number of independent grocery stores	Woolworths; Big W; Coles; Metcash; FAL; Bidvest; other major retailers
Tobacconists	Independent specialised tobacco retailers	Smokemart; Tobacco Station and other tobacconist groups or individual tobacconists
Convenience Stores	Includes stand alone convenience stores and stores that are co-located with petrol stations	7-Eleven; NightOwl and extended hours and stores operated by petrol companies where they offer a range of grocery and related products
Mixed Businesses	A wide range of mixed businesses, including local grocery retailers, corner stores and takeaway stores	Corner stores; delicatessens; independent grocers
Hotels and Clubs	Businesses primarily involved in hospitality and accommodation	National chains and independent stores
Liquor Stores	Businesses that operate as stand alone liquor outlets	National chains and independent stores
Newsagents	Undertake sales of newspapers and a varying range of other goods	National chains and independent stores
Petrol Stations	Undertake sale of petroleum goods as well as various groceries and snack foods	Caltex; BP; Shell; Mobil; independent petrol retailers
Other Retailers	Predominantly cafes and restaurants	Restaurants; cafes

This retail classification structure highlights some general implications:

- each type of retail business typically contains a mix of business sizes: there are variations from larger, even national, chains or groupings to smaller, independent stores sometimes operating in a relatively isolated regional context;
- with this range of operating characteristics, there are varying capacities of chains or stores to generate and spend capital, to employ a range of staff in addition to having owners operating businesses and to provide a variety in the range of goods offered for sale; and
- smaller retail premises may lack the access to capital and staff that larger chains may have but they compensate for these issues in seeking to compete based on differentiating their business from others.

Types of Retailers – characteristics

The characteristics of each of the nine types of retail businesses, particularly with respect to the sale of cigarettes and tobacco products, are summarised in **Table 3.2**:

Table 3.2: Characteristics of Retail Business Types

Retail Business Types	Key Characteristics
Supermarkets and Grocery Stores	<ul style="list-style-type: none"> outlets are all fairly homogeneous with a reasonably diverse product range have more capacity to invest substantial capital in their businesses and to staff specialised points that sell cigarettes and tobacco products typically retail a very wide range of dry groceries and non-specialised food lines, usually on a self-service basis offer cigarettes and tobacco products at discounted prices stock products also bought in bulk (i.e. cartons) as part of weekly shopping purchases may have an offer for discounted fuel at linked petrol stations for customers who spend over a specified limit
Tobacconists	<ul style="list-style-type: none"> retail a comprehensive range of cigarettes and tobacco products and accessories offer cigarettes in bulk at discounted prices incorporate ancillary goods into their product range to diversify their business and hence, extend the sources of sales generation
Convenience Stores	<ul style="list-style-type: none"> rapid growth in outlets, in part due to outlets being co-located with petrol stations usually occupy smaller premises, although area devoted to retail is growing may operate 24 hours a day, 7 days a week, regardless of location sell a wide range of 'fast' foods, home meal replacements, food lines and groceries along with cigarettes and tobacco products; many also offer services, such as ATMs, entertainment products and phone cards mostly sell individual packets of cigarettes and roll-your-own tobacco
Mixed Businesses	<ul style="list-style-type: none"> have a wide range of characteristics from relatively large outlets to smaller corner stores and family owned and operated businesses take away food outlets comprise a significant proportion of mixed businesses also include general stores, milk bars, delicatessens and the traditional 'corner store' are often located in smaller population centres and are, thus, a significant source of goods and associated services for that region
Hotels and Clubs	<ul style="list-style-type: none"> primary business is offering accommodation, hospitality and associated activities encompasses a variety of hotels and clubs that sell the majority of their cigarettes through vending machines vending machines provide an important service to patrons who need to buy a packet of cigarettes but cannot go to their usual retail outlet vending machines are popular with proprietors as no staff are required and there are limited losses through theft

Retail Business Types	Key Characteristics
Newsagents	<ul style="list-style-type: none"> • a specialist type of retailer predominantly selling newspapers and other publications • may be a member of a national group or may operate independently • also provide services related to lotteries and other gaming activities • can retail a limited range of dry food stuffs, as well as cigarettes and tobacco products
Liquor Stores	<ul style="list-style-type: none"> • stand alone premises (that is, they are not attached to a hotel, for example) • sell a very wide range of liquors and other beverages
Petrol Stations	<ul style="list-style-type: none"> • predominant business is the sale of petrol • also sell a relatively limited range of dry and convenience foods • sell cigarettes and tobacco products as an important adjunct to their other retail sales
Other Retailers	<ul style="list-style-type: none"> • a declining source of business for cigarettes and tobacco products, largely through increasing prohibition of smoking in these premises • typically, only single packets are offered and, hence, higher gross margin percentages are typically achieved

Route trade and small businesses

A major issue which is impacting on the structure of retail industry is the emerging pattern whereby route trade businesses are losing ground to supermarkets and convenience stores. Retailers are considered to be in route trade when they are located outside shopping malls and similar centres. Typically they will be located either in strip shopping precincts or by themselves. Common outlets that have traditionally been located in route trading areas are corner stores, fruit and vegetable shops, tobacconists, liquor stores, chain convenience stores and newsagents.

Another typical characteristic of route trade retailers is that they are usually small businesses. It is difficult to define these small businesses precisely so there is no universally accepted definition. The most commonly used definition for small businesses is a business with 20 people or less. The ABS categorises small businesses by the number of employees:

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

This approach is supported by the Small Business Coalition, who commissioned a study on the definition of small businesses. This research devised the following definition of a small business:

“A small business is a business which is independently owned and operated, with close control over operations and decisions held by the owners. Business equity is not publicly traded and business financing is personally guaranteed by the owners. The business will have less than twenty employees.”⁷

According to these definitions, many tobacco retailers are small businesses, particularly those in the tobacconist, convenience store and mixed business retail types. Research has found that these small businesses are often located in route trade districts, and it is these locations that are currently facing increasing competitive pressures from the larger shopping centres.

A recently released BIS Shrapnel report shows that there has been a marked decline of six per cent in the number of route trade businesses in Australia over the last three years – from 44,900 in 2001 to an estimated 42,200 in 2004.⁸ This is a significant drop over a relatively short period, and has occurred at a time when retail sales generally have been maintained at a strong level.

This has significant implications for small businesses that retail cigarettes and tobacco products, particularly for those in route trade locations. Changing consumer patterns and increasing regulation in relation to the display of tobacco products are likely to impact adversely on these types of retailers. These issues, therefore, will have important consequences for the shape of the future business model of small tobacco retailers.

⁷ Gibson. S.H.B. Professor, *“Definition of Small Business Final Report”* The University of Newcastle, 5 April 2001.

⁸ *Route Trade in Australia, 2004 to 2006*, BIS Shrapnel, July 2004.

4. Performance by type of tobacco retailer

Overview

During 2004, the total value of all retail sales in Australia was \$197 billion⁹, and sales of cigarettes and tobacco products were approximately \$9.3 billion.¹⁰ Therefore, cigarette and tobacco sales represent around 4.7 per cent of total retail sales, and approximately 12 per cent of the total expenditure on foods and groceries.¹¹ As a proportion of total retail sales, the value of cigarette and tobacco sales has decreased by approximately 0.3 per cent in the five years since 1997-98.¹²

It is estimated that, out of the 100,000 retailers in Australia, approximately 35,000 sell cigarettes and tobacco products.¹³ This represents a 12.5 per cent decrease in the number of retailers selling tobacco products since 1999.¹⁴ While there has been an increase in the number of convenience stores operating, this has been more than offset by a reduction in the number of smaller, mixed grocers and tobacconists.¹⁵

Sales of cigarettes and tobacco products are a significant feature of retail sales across most of the nine retail types, and this has remained a consistent characteristic of retailing since the analysis in 1999.¹⁶

The magnitude of cigarette and tobacco sales is evidenced by the fact that the three tobacco manufacturers in Australia are in the top 10 packaged grocery suppliers;¹⁷ moreover, six of the top ten branded goods by value during 2002-03 were cigarettes.¹⁸ The annual sales of these brands have increased to more than \$5.5 billion in 2004¹⁹ from \$1.5 billion in 1999. The large increase in the sales of these brands is largely due to increases in tobacco excise.

⁹ *Bulletin 8501.0, Retail Sales, February 2005*, ABS.

¹⁰ Industry information.

¹¹ ABS retail sales data.

¹² PricewaterhouseCoopers, (1999) p.3.

¹³ Derived from data supplied from retail industry associations and from *Bulletin 8622.0, Survey of Retail Industry, 1998-99*, ABS.

¹⁴ PricewaterhouseCoopers, (1999) p.4.

¹⁵ *Route Trade in Australia, 2004 to 2006*, BIS Shrapnel, July 2004.

¹⁶ PricewaterhouseCoopers, (1999).

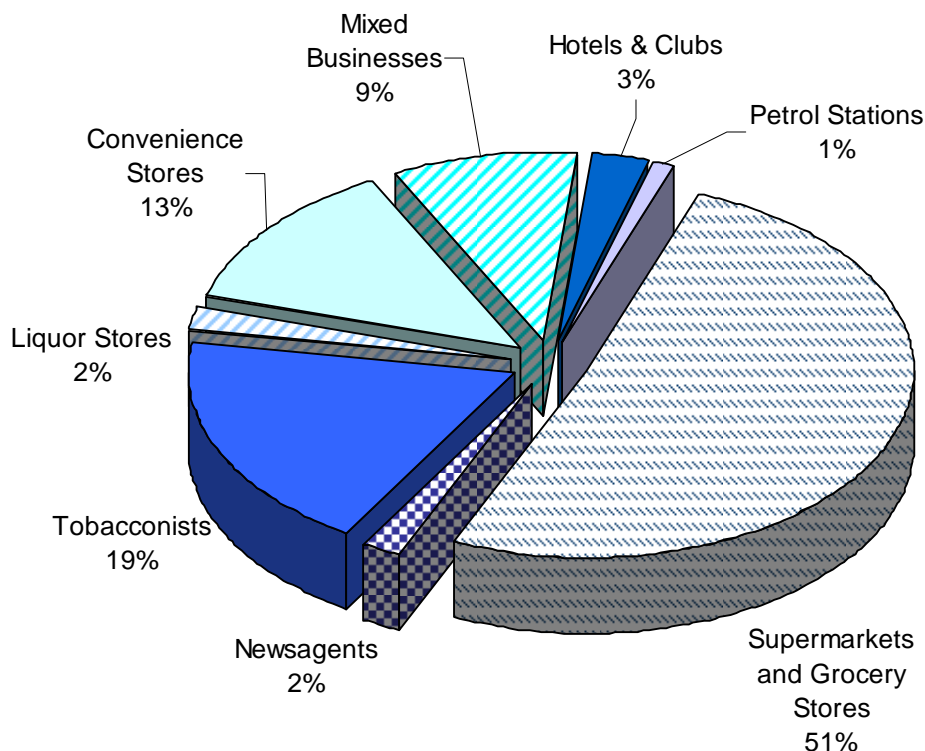
¹⁷ ScanTrak study of the top 100 suppliers of packaged groceries, AC Nielsen.

¹⁸ The brands in the top 10 and their rankings were: Coca-cola (1); Longbeach (2); Winfield (3); Peter Jackson (4); Horizon (5); Pura (6); Benson & Hedges (7); Huggies (8) Holiday (9) Cadbury chocolates (10); AC Nielsen, www.acnielsen.com.au

¹⁹ AC Nielsen Scan Data 'Share of Total National Cigarette Market' Period ending Dec 2004; excludes Duty Free and Tobacco Specialist sales.

The proportion of sales of cigarette and tobacco products across each type of retailer is provided in **Figure 4.1** below.

Figure 4.1: Proportion of Sales of Cigarettes and Tobacco Products by Retail Type



Source: Estimates derived from industry statistics and information obtained from various ABS Bulletins.

Types of Retailer

There have been some quite dramatic changes in the structure of retailing that have affected the retailing of cigarettes and tobacco products over the past five years or so. These developments are analysed in the following sections:

Supermarkets and Grocery Stores

Supermarkets and Grocery stores now account for around 51 per cent of all sales of cigarettes and tobacco products in Australia. This is a substantial increase on the situation in 1999, when this retail type accounted for just over a third of all sales of cigarettes and tobacco products. This result supports the outcome of survey results provided by the ABS in 1998-99, which found that supermarket chains and grocery stores sold 48 per cent of cigarettes and tobacco products over that period.²⁰

This comparison of results from different sources clearly reveals the increasing dominance of these stores in the sale of cigarettes and tobacco products.

²⁰ ABS - Bulletin 8624.0, Retail Industry, Commodity Sales, 1998-99.

This prominent position is reinforced by the changing shopping patterns of consumers of cigarettes and tobacco products, as people increasingly shift towards shopping in large shopping centres. This is likely to see many route trade retailers attempting to move their operations in to shopping centres and similar sites.

Tobacconists

Sales made by the traditional tobacconist are almost entirely cigarettes and tobacco products and associated goods. These stores often sell cigarettes in bulk at discounted prices. Therefore, in order to make sustainable gross margins, this retail type depends on support from tobacco manufacturers – and, in turn, this support is dependent on the tobacconist achieving sales above a certain threshold.

Some tobacconists have been adversely affected by changing patterns of retail consumer behaviour, while others, who have established good locations in malls and similar centres, appear to be maintaining their relatively strong position. Tobacconists are now retailing around 19 per cent of total cigarettes and tobacco products sales compared to around 20 per cent in 1999.

The BIS Shrapnel report identifies that tobacconists who have been located in more traditional sites are declining as a result of consumers choosing different locations for their purchases of food and groceries generally and, consequently, for their purchases of cigarettes and tobacco products.

This trend is further affected by high rents in shopping centres and the fierce competition with nearby major supermarkets. Additionally, anecdotal evidence indicates that some tobacconists report difficulties in retaining retail space in large shopping centres due to the higher rent levels.

Convenience Stores

One of the most significant changes that has taken place in retail industry over the last five years has been the growth of convenience stores. This continuing strong growth of convenience stores reflects such factors as changing lifestyles and shopping patterns, including increased shopping outside traditional hours.

Convenience stores now account for 13 per cent of retail sales of cigarettes and tobacco products. The number of these convenience stores has increased from 931 in 1998 to 1,164 in 2000 and then to more than 1,655 in 2003, representing a 78 per cent increase in the number of convenience stores in seven years.

Total sales of cigarettes and tobacco products made by convenience stores have grown from around \$360 million in 1999 to \$1.2 billion in 2004.²¹ Convenience stores are now the third highest by type of retailer for generating revenue from sales of cigarettes and tobacco products.

One feature of sales of cigarettes and tobacco products in these stores is the impact of ancillary buying. There is a strong pattern of consumers who intend to buy a packet of cigarettes in these stores and who, while doing so, buy other goods.

²¹ *State of the industry survey Australia – year ended December 2003*, Australasian Association of Convenience Stores, August 2004.

Although it is difficult to put a precise value on the nature of ancillary buying, evidence suggests that it is an important factor in generating revenue and, hence, profits from sales of cigarettes and tobacco products in these stores.²²

Mixed Businesses

There are many thousands of stores that are classified as mixed businesses. It is difficult to generalise about this type of retail store because they cover such a diverse range of locations, sizes, operating parameters and other characteristics. Outlets range from large stores to kiosks that operate in defined and limited locations. However, there appears to be a decline in the number of mixed businesses as pressures grow on stores operating in the traditional route trade locations.

On average, mixed businesses now supply around 9 per cent of all sales of cigarettes and tobacco products. While this remains a significant component of the overall retail market, it does represent a decline from the 15 per cent of total cigarettes and tobacco products sales achieved in 1999. Given the range of mixed businesses, there is a reasonable variation in the relative importance of cigarettes and tobacco products sales to these businesses. Some mixed businesses (e.g. some milk bars and corner stores) apparently derive up to 40 per cent of their gross revenue from sales of cigarettes and tobacco products, while other stores generate lower proportions of revenue from these goods (see table E1).

As with sales made by convenience stores, a particular feature of sales of cigarettes and tobacco products by mixed businesses is the importance of ancillary buying in improving sales revenue. While there is limited data available to confirm that customers exhibit such behaviour, it seems to have considerable validity.

Hotels and Clubs

Hotels and clubs represent an increasing source of revenue from sales of cigarettes and tobacco products. Sales of these goods in 2004 are estimated at \$244 million compared to a value of \$133 million in 1999.

The main reason for this growth would appear to be the important role of vending machines. Sales from vending machines represent a small component of the sales of the premises where they are located, usually hotels, pubs and clubs. The proprietors of clubs, hotels and other premises do not see vending machines as a key part of their marketing strategy, but rather as providing a service for patrons.

Nevertheless, vending machines are considered to be a more cost effective and convenient option to sell cigarettes and tobacco products to the public in the hotels, clubs and similar venues. Vending machines are preferred by these venues because they do not require staffing and they overcome stock control and theft.

Hotels and clubs are concerned about potential threats to increase regulation that aims to limit the number of vending machines. These regulations are intended to target the use of these machines by minors, although there is some doubt it will be effective.

²² Anecdotal information received during industry consultations.

Newsagents

Newsagents experience high levels of ancillary sales from consumers who buy a packet of cigarettes and, once in the store, they may also buy other goods, such as a newspaper, lottery games or confectionary.

Sales of cigarettes and tobacco products by newsagents have fallen quite significantly over the last five years. Sales of cigarettes by manufacturers and wholesalers to newsagents of have fallen 48 per cent from \$330 million in 1999 to \$171 million in 2004. Some factors behind this apparent decline are likely to include a combination of:

- as prices rise a shift by some customers to other retailers with lower gross margins such a larger tobacconist chains and supermarkets; and
- a shift buy some newsagents to improve margins by purchasing their stocks of cigarettes (often as a group of newsagents) via larger tobacconists rather than through representatives of the manufacturer or wholesalers.

Hence the purchasing through alternative channels means the actual change in dollar sales of cigarettes and tobacco products by newsagents is likely to be relatively a modest. The change in purchasing patterns by some newsagents towards lower cost suppliers is likely to reflect a response to price competition from supermarkets and a desire to try to retain historic levels of gross margin.

Liquor Stores

Liquor stores have recorded a reasonable rise in the value of sales of cigarettes and tobacco products – from almost \$100 million in 1999 to around \$151 million in 2004. Sales of these cigarettes and tobacco by liquor stores, however, are very much an incidental activity.

Petrol Stations

Petrol stations also appear to have experienced a decline in sales of cigarettes and tobacco products. However, some changes in the definitions of retailer types preclude accurate comparisons with 1999 sales results. The 2004 sales are estimated at around \$92 million. The 1999 for petrol station sales were substantially higher which was mainly due to convenience stores with petrol facilities being defined as petrol stations.

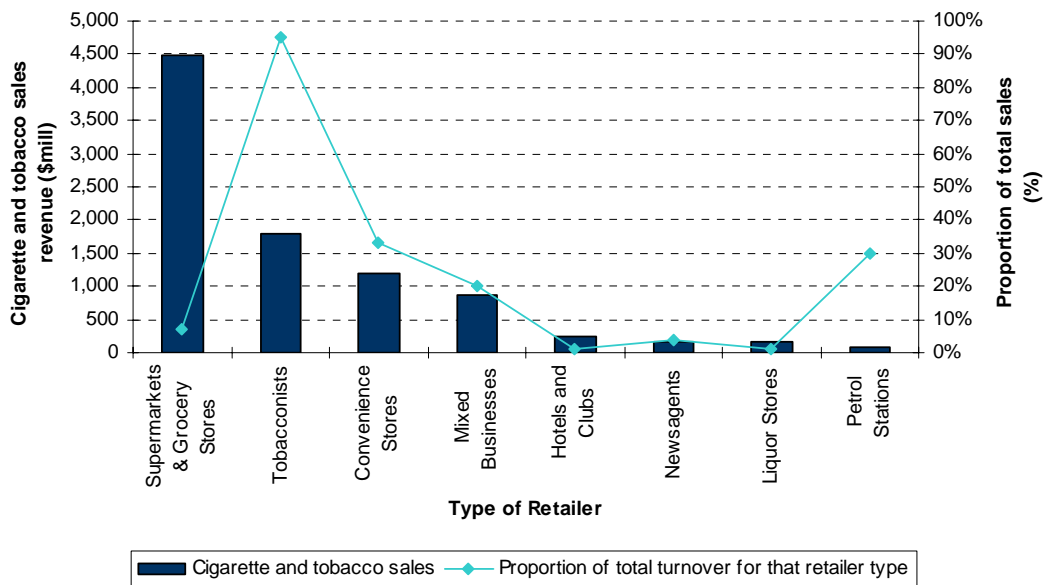
Other Retailers

It would appear that the increasing prohibition of smoking in restaurants, cafes and similar premises has caused sales of cigarettes and tobacco products from these premises to fall to comparatively minor levels.

Analysis of sales

Revenue generated from sales of cigarettes and tobacco products continues to be a significant component of total sales across all relevant retailer types. **Figure 4.2** below shows the sales revenue from cigarette and tobacco products for each type of retailer in 2004; it also shows cigarette and tobacco sales as a proportion of total sales for each type of retailer.

Figure 4.2: Cigarette and tobacco sales; 2004



This analysis clearly shows that the quantum of sales revenue from cigarettes and tobacco products is not closely related to the proportion of total sales for each type of retailer. High volumes of sales revenue from tobacco products do not necessarily indicate an increased significance of these goods for retailers.

Other key findings from this analysis are:

- Supermarkets and Grocery stores achieve the largest aggregate sales of cigarettes and tobacco products, however, this only represents 8 per cent of the total sales of these stores, because such stores sell an extremely wide range of goods;
- Tobacconists, as specialist retailers of cigarettes and tobacco products, reflect this outcome in their results, where around 95 per cent of their total sales revenue is generated from sales of cigarettes and tobacco products;
- Convenience Stores emphasise the critical importance of sales of cigarettes and tobacco products for a number of retailers. These stores generate around 30 per cent of all their revenue from cigarettes and tobacco products; likewise, petrol stations have quite a high dependency on cigarette and tobacco sales to generate revenue in addition to their petrol sales ;

- Mixed Businesses also reflect the overall importance of revenue generated from sales of cigarettes and tobacco products. Although there is a wide variety of outcomes across mixed businesses, in some situations, revenue from cigarettes and tobacco products comprises from 21 per cent up to 40 per cent of total revenue;
- For the types of retailers where sales of cigarettes and tobacco products are relatively small, the importance of these products is much less significant.

Analysis of profitability

The gross margin of a business can be used as a broad indication of the profitability of these businesses. Gross margin is the difference between the price for which a business purchases goods and the price for which these goods are sold. Data indicates that, for some types of retailer, profit levels rely substantially on the high gross margins earned from sales of cigarette and tobacco products.

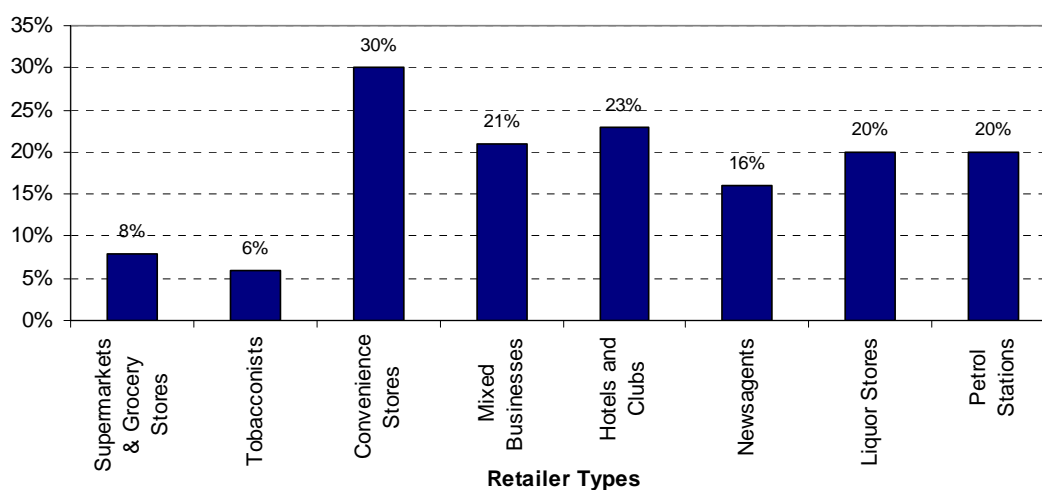
Table E.1 (Cigarettes and Tobacco Products – Key Characteristics, 2004) within the Executive Summary of this report provided the total sales revenue achieved for each type of retailer in 2004 with estimated sales revenue into the wholesale cost and estimated gross margin. Table E.1 illustrates that the quantum of gross margin generated by each retail business type differs considerably. It is evident that convenience stores, hotels and clubs, mixed businesses, liquor stores and petrol stations generate the highest margins with their focus on single packet sales, often with some sales of ancillary products and a fast turnaround time. By contrast, tobacconists generally target higher volumes at lower margins due mainly to their focus on discounted carton sales. There is a focus on different customer segments, therefore, by different retailers – depending on their marketing strategies – and these strategies can achieve varying gross margins in each type of retail business.

Another key retail profitability measure is the floor space utilised to sales ratio which provides a measure of the efficiency of stock space allocations. Cigarettes and tobacco products are generally very strong performers on this measure in that, tobacconists aside, they typically account for a minor proportion of floor space (say 2-5 per cent) but for a number of types of retailers (eg convenience stores and mixed businesses) they generate a far larger proportion of total sales (see Figure 4.2).

The estimated gross margin by for each retailer type is illustrated in **Figure 4.2** below. The graph represents gross margin revenue as a proportion of total sales revenue for each type of retail business, in the left column.²³

²³ The following formula is used to calculate the gross margin earned as a percentage of total sales; gross margin (%) = (retail sale price – wholesale cost)/ retail sale price.

Figure 4.2: Comparison of gross margin by retailer type



This analysis shows that the gross margin earned on cigarettes and tobacco products is lower for supermarkets and grocery stores, at around 8 per cent, and for tobacconists, at around 6 per cent. The generalised pricing strategy of supermarkets, grocery stores and tobacconists is to offer tobacco products at lower prices and to seek a greater proportion of bulk or carton sales to generate higher turnover. This is confirmed by the fact that these two types of retailers occupy the top two positions for aggregate sales of cigarettes and tobacco products.

An alternative pricing approach used mainly by convenience stores, mixed businesses and hotels and clubs is to provide a faster and more convenient service with a focus on single packet sales at relatively higher prices.

The pricing and profit strategies clearly show the different approaches of each type of retail business, and the characteristics of each of the nine types of retail businesses, particularly with respect to the sale of cigarettes and tobacco products, are summarised below in **Table 4.1**:

Table 4.1: Cigarette and tobacco sales and gross margins by retail business types

Retail Business Type	Total Sales \$ mill	Gross Margin %	Characteristics
Supermarkets and Grocery Stores	\$4,478m	8%	<ul style="list-style-type: none"> • Target high volumes of sales on relatively low margins. Thus, the gross margin revenue achieved on cigarettes and tobacco products represents a good contribution to aggregate profitability • The extremely competitive nature of supermarkets places particular importance on the gross margins achieved from the sale of cigarettes and tobacco products
Tobacconists	\$1,800m	6%	<ul style="list-style-type: none"> • The margins achieved by tobacconists are quite low due to their emphasis on offering specialisation and discounts to compete with large retailers and shopping complexes • Where tobacconists are not located in such a competitive environment, they are able to generate higher margins and good profits • Research indicates that some route trade tobacconists are slowly being forced out of the market.
Convenience Stores	\$1,203m	30%	<ul style="list-style-type: none"> • Cigarettes and tobacco products generate high gross margins for convenience stores because these stores generally target sales of single packets or small numbers of packets of cigarettes
Mixed Businesses	\$875m	21%	<ul style="list-style-type: none"> • Some of these businesses operate on relatively lower margins across reasonably high sales volumes over their product range. • Other stores are in locations where they are the sole local grocery retailer. This means that they are able to command higher margins from sales of most goods, including cigarettes and tobacco products. • The gross margin achieved on cigarettes and tobacco products represents a valuable contribution to their profitability
Hotels and Clubs	\$244m	23%	<ul style="list-style-type: none"> • These premises tend to sell single packets or small numbers of packets of cigarettes • Reasonable margins are achieved from the relatively low volumes of sales of cigarettes and tobacco products sold in vending machines • Revenue from sales of cigarettes and tobacco products represents a relatively minor contribution to overall sales and profitability

Retail Business Type	Total Sales \$ mill	Gross Margin %	Characteristics
Newsagents	\$171m	16%	<ul style="list-style-type: none"> • These stores tend to sell single packets of cigarettes and generate reasonable margins on these sales • Revenue from these sales represents a relatively minor contribution to overall sales
Liquor Stores	\$151m	20%	<ul style="list-style-type: none"> • These premises tend to sell single packets or small numbers of packets of cigarettes, while achieving reasonable margins on these sales • Revenue from these sales represents a relatively minor contribution to overall sales
Petrol Stations	\$92m	20%	<ul style="list-style-type: none"> • Petrol stations achieve high margins on sales of cigarettes and tobacco products, because they sell individual packets of cigarettes at the full recommended retail price. This offsets the low margins achieved on sales of petroleum products

5. Issues affecting the industry

There are a number of significant issues that affect the prospects of many retailers of cigarettes and tobacco products, as these issues impinge on the capacity of retailers to respond effectively to increasing competitive pressures. It is perceived that appropriate responses to these issues are particularly critical to the viability of smaller retailers.

Restrictions on display

The latest policy approach from States and Territories to tackle the issue of sales of cigarettes and tobacco products to minors, proposes prohibiting the display of cigarettes and tobacco products.

At the time of writing, South Australian, Western Australian and New South Wales Governments are considering proposals to ban the display of tobacco products at retail point of sale. It is likely that other State Governments will consider similar legislation. As is noted above, the South Australian Government committed to further consultation before proceeding with its legislation. In November 2004, the Queensland Government announced its decision to limit the display of tobacco products to one square metre from 1 January 2006.²⁴

It is not the place of this report to argue the merits or otherwise of proposals to prohibit the display of cigarettes and tobacco products. This has been undertaken most effectively by various industry associations.

In interviews with smaller tobacco retailers, a number reported concerns that these proposals are likely to have an adverse impact on their profitability and viability. Some of the concerns of small tobacco retailers are:

- cigarettes and tobacco products are legal products, yet there appears to be an excessive level of regulation;
- substantial capital costs of complying with any anti-display legislation, with some expenditure estimates of around \$50,000 per retail checkout;²⁵
- obvious physical limits to how cigarettes and tobacco products can be stored for sale if display were banned, most particularly in small retail outlets; and
- all options impose an increased risk of attacks on staff, who will be required to take their eyes off customers to bend down, turn around or reach overhead. In small retail outlets, this situation is exacerbated by the low numbers of other staff.

Tobacconists also report concerns about the significant consequences from excessive regulation as they rely almost predominately on the sale of cigarettes and tobacco products. Restrictions on their ability to display these goods will impede their operations and decrease the value of their stores.

There is concern among tobacco retailers that these policies put too much responsibility for corrective action on retailers rather than addressing the issue at its source by reducing or eliminating the incidence of smoking amongst younger people.

²⁴ Jowett, P. "Display size will force jobs to go up in smoke", *The Courier Mail*, 18 November 2004, p 21.

²⁵ Industry consultations.

In association with the tobacco manufacturers, a large proportion of retailers stated that they devote considerable energy to ensuring that cigarettes and tobacco products are not sold to minors.

Ultimately, the potential response of some smaller retailers may be that it is simply too expensive to comply with all the regulations and other imposts necessary to retail cigarettes and tobacco products. However, small to medium retailers are also concerned that any decision to remove cigarettes and tobacco products from their product mix could reduce the viability of these businesses. The closure of these businesses may result in a loss of retail outlets in some communities (perhaps where there are few alternative retail outlets) and the loss of job opportunities (especially in some communities where the retailer is a large employer).

Policy approach to small business

Retailers involved in selling cigarettes report that there appears to be a degree of inconsistency in the government's policy approach to small retailers. Policies which seek to encourage the growth of small businesses can potentially be partly offset by policies that will restrict the activities of many smaller retailers. The overall policy objective for governments is to create an environment which is conducive for small businesses to thrive and grow.²⁶ This recognises that small businesses are a significant component of the Australian economy, particularly in generating jobs.

However, these policies appear to be partially offset by regulation restricting the sale of cigarettes and tobacco products. Driven by objectives to promote the health of the community and protect the interests of minors, the retailing of cigarettes and tobacco products is subject to increasing regulation, such as recent initiatives which propose to limit the display of cigarettes. For most small business retailers, these policies are likely to have high capital costs as well as placing impractical restrictions on their business.

Small tobacco retailers believe that the health-related policies are at odds with the policy objectives being sought through industry policies and programs. At the same time, governments express concern about the difficulties facing smaller businesses and commit to making the business environment more friendly.

There are major concerns that, as the capital costs of compliance are proportionally higher for small retailers, this will significantly impact upon the competitive position of these businesses. In acknowledgement of evidence that small retailers could be harmed by the restricted display of cigarette and tobacco products, the South Australian Government recently delayed policy implementation to allow for further consultations.²⁷

²⁶ Policy approaches of the Federal, State and Territory Governments towards encouraging small business are set out in the relevant web sites of the relevant industry departments: such as www.ausindustry.gov.au; www.business.gov.au; www.business.act.gov.au.

²⁷ Letter to the Executive Director, State Retailers Association of South Australia from the Hon. Lea Stevens, MP, Minister for Health, 19 July 2004.

Ancillary sales

An activity that is closely associated with the sale of cigarettes and tobacco products is the analysis of the 'drivers' that influence people to purchase these products.²⁸

Anecdotal evidence suggests that consumers in convenience stores who wish to purchase cigarettes and tobacco products also purchase other goods. Consequently, these stores benefit from both the sale of the tobacco product and the ancillary sale. The combined impact is a major contribution to the sales and profitability of these stores.

Employment implications

With around 35,000 retail outlets selling cigarettes and tobacco products across Australia, these outlets provide employment for around 500,000 people. This includes the employment of full time proprietors (around 3 per cent), with the balance being a combination of full time, part time and casual staff.²⁹

It is difficult to quantify the impact on retail employment from the possible increase in regulation of sales of cigarettes and tobacco products (such as prohibitions on the display of these products).

Preliminary analysis of the possible impact on retail employment from increasing regulation indicates that there is likely to be a small net loss in this area. Moreover, there will also be employment impacts associated with the broader retail trend which is seeing declines in route trade offset by rises in organised or shopping centre based trade. As tobacco sales shift towards convenience stores, it is expected that the bulk of this shift will be serviced by the existing staff in these stores. However, the requirement to manage tobacco sales without these products being on display could also have some employment implications. Mixed businesses and tobacconists generally have more labour intensive operations than other retailers, such as convenience stores. Overall, it is expected that there may be some workforce reduction in types of retailer (eg tobacconists and mixed businesses) that will be partially offset by some small growth in employment in other retailers (eg convenience stores).

Smaller retailers are more likely to experience worse effects, as this group generally operates over quite long opening hours. Any significant loss of sales and margin in smaller retailers can see pressure to reduce the hours being worked by employees or to reduce the number of staff. Some of these businesses will try to maintain their profitability by using fewer people; whereas others will reduce their hours of trading as a consequence of having less staff. Overall, there is little reliable empirical information on the employment impact arising from restricting the sale or use of cigarettes and tobacco products.

²⁸ The market research organisation, AC Nielsen, has recently started to research the basis for ancillary buying. At this point, however, no results are available from this research.

²⁹ Derived from data supplied from retail industry associations and from Bulletin 8622.0, Survey of Retail Industry, 1998-99, ABS.

Of particular concern is the potential impact on retailers in smaller population centres, where these businesses often perform a valuable role in being the sole provider of a wide range of groceries and associated goods. The potential loss of sales of cigarettes and tobacco products could have a major adverse impact on their commercial viability. Where such retailers are already struggling, the additional regulations may see these communities lose the retailer, one or more families, and an overall loss of employment.

Illegal tobacco

There is strong evidence that the impact of taxes (excise and GST) which comprise 70 per cent of the price of legal cigarettes and tobacco products have led to the growth of the illegal sales of tobacco known as 'chop chop', in the last five years. This product is tobacco that is diverted from legal channels of sale and distribution, thereby avoiding tax and excise. 'Chop chop' is grown on licensed farms, in backyard plantations or is imported illegally, and is sold on the Australian black market in relatively large quantities.

As with any illegal activity, it is difficult to quantify the size and value of the 'chop chop' market. Estimates of the size of the market vary between 0.4 and 2.6 million kilograms per annum, which translates to approximately \$450 million in lost tax and excise revenue per year.³⁰

In 2003, the general market price for 'chop chop' stood between \$80 and \$160 per kilogram, compared to a kilogram of legal roll-your-own (RYO) tobacco that retails for around \$423.³¹ The ANAO suggest that the 'chop chop' supply chain is becoming more sophisticated and involves crime syndicates and other criminal organisations.

For legitimate retailers, these trends have serious implications, as 'chop chop' does appear to be widely available and is sold at numerous retailers including tobacconists, hotel bars, street markets, hairdressers, newsagents and milk bars.³² These estimates imply that the lost profit to retailers could range between \$30-\$35 million.³³ Anecdotal evidence suggests that 'chop chop' is available in all States and Territories, with a particular concentration in the large population centres on the eastern seaboard of Australia.

³⁰ This estimate is based on a recent update of a model initially developed by industry and the ATO, which estimates the size of the illegal market based on the volumes of imported tubes and papers used in the consumption of 'chop chop' (unpublished at the time of writing this report). Lost tax is based on estimate of \$227 per kilogram

³¹ The Commissioner of Taxation – Annual Report 2002-2003.

http://www.ato.gov.au/corporate/content.asp?doc=/content/39007.htm&page=172&H8_5_3

³² PricewaterhouseCoopers, *The Current Economic and Public Environment for the Australian Tobacco Industry*, 2001, page 47

³³ PricewaterhouseCoopers, "Research Report on the Illegal Tobacco Market" (2005), pp. 38-41.

Retail industry associations anticipate that further restricting access to cigarettes and tobacco products is likely to result in an increase in the production and distribution of illegal tobacco products. Banning the display of legal cigarettes and tobacco products would blur the distinction between legal and illegal products. Some survey results suggest there may be a substitute relationship between 'chop chop' and some legal tobacco products, which may lead to an increase in the demand for the cheaper, illegal product.³⁴

Insurance

Increasing insurance costs are a problem for retailers of cigarettes and tobacco products. Insuring tobacco and cigarette products is a critical issue as these products are often targeted for theft.

Retailers of cigarettes and tobacco products are required to pay a substantial premium in order to sell these products and the component of the insurance premium attributable to cigarettes and tobacco products can comprise around 25 per cent of the total premium paid by a retailer. Moreover, the insurance premium for cigarettes and tobacco products can be around a 30 per cent of the value of the stock of cigarettes and tobacco products held on premises.

The result of these relatively high premiums is that a number of premises choose not to be covered by insurance for these products. There is a considerable risk to the business from this decision and, in the extreme, a business may be forced to close because of the cost of recovering from the damage caused by the theft of their cigarette and tobacco stock.

State differences

There appears to be limited evidence of significant differences in cigarette and tobacco purchasing behaviour between Australian States and Territories. The few identified differences are:

- The Northern Territory has the highest spending per capita on tobacco products, followed by the ACT, with the lowest spending in Tasmania. This is illustrated in **Figure 5.1**.
- Research indicates that there appear to be lower sales of "chop chop" in Western Australia.

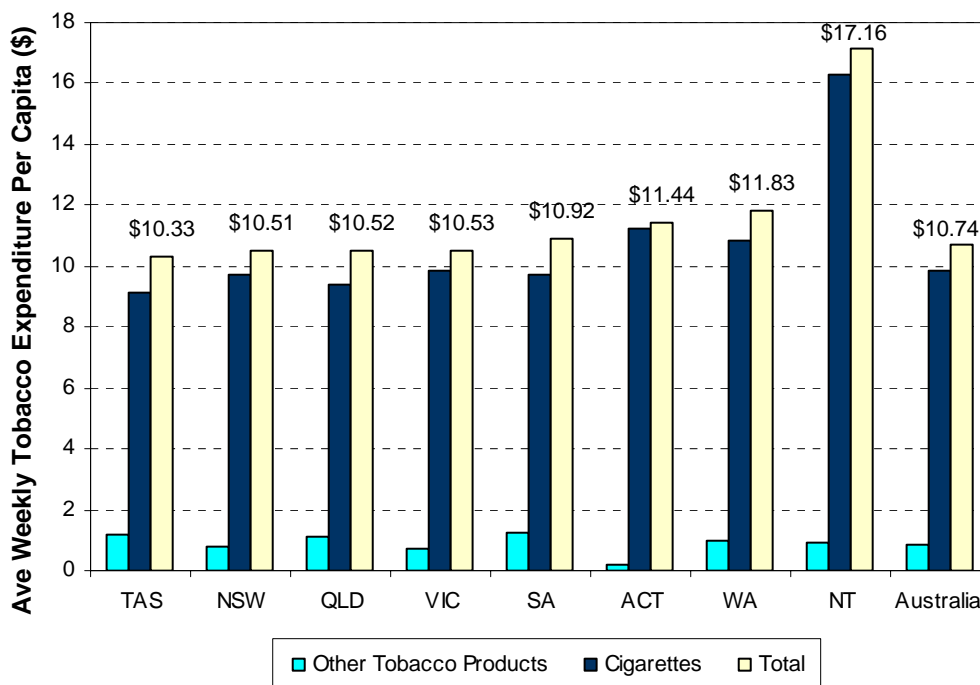
The results in **Figure 5.1** are derived from an ABS survey on household expenditure. This survey included the average spending per capita on tobacco products in each State and Territory in 1998-99. It is evident that the majority of spending is on cigarettes, with only a small amount of expenditure on 'other tobacco' and 'tobacco not elsewhere classified.'

According to this data the national average expenditure on tobacco products is \$9.86 per week. Tasmania recorded the lowest level of spending on tobacco products. The situation within NSW, VIC and QLD is broadly comparable, while spending in SA is a little above that in these three States. The level of spending then rises for the ACT and WA.

³⁴ Australian Institute of Health and Welfare 2001 and BATA consumer tracker data 2003.

Per capita spending on tobacco products in the Northern Territory is significantly above per capita spending in all other States due mainly to greater prevalence of smoking amongst indigenous males (and also to a lesser extent non-indigenous males) in the 'Top End' Region of the Northern Territory.³⁵

Figure 5.1: Average weekly expenditure per capita on tobacco products, 1998-99



Licensing

It has been suggested that cigarettes and tobacco retailers should be licensed. Licensing of retailers has high administration and compliance costs. It is perceived that the effect of such an initiative would be similar to policies which prohibit display of tobacco products. Three jurisdictions currently licence tobacco sellers: South Australia, Tasmania and the Australian Capital Territory. However, other jurisdictions have negative licensing which penalises retailers who breach tobacco control provisions, including the loss of the right to sell or display tobacco products.

There is concern that there are already numerous licences for which retailers have to be responsible, and the benefits of such a licensing regime are unlikely to exceed the high compliance and administration costs imposed, both on business and the community.

³⁵ For further discussion on this issues see: ABS Occasional Paper: Cigarette Smoking among Indigenous Australians, 1994 (4701.0).

6. Conclusions

This report provides an analysis of the significance of sales of cigarettes and tobacco products in Australia during 2004. The main conclusions of this report are:

- The sale of cigarettes and tobacco products plays an important role in generating sales revenue and gross margins for a large number of retailers across a range of different types of retail businesses. Hence, these sales are a key driver in the profitability and viability of a substantial proportion of retailers. Consequently, any increase in the regulation of tobacco sales which has a significant adverse impact on turnover is likely to have an adverse impact on the viability of a significant proportion of retailers.
- The number of tobacconists and mixed businesses has declined as a result of changing consumer behaviour and the competitive pressure placed on route trade stores by major shopping centres. The introduction of legislation and regulations restricting product display is particular concern to tobacconists and mixed businesses due to the capital expenditure required to comply with legislation, and the substantial revenue they derive from the sale of cigarette and tobacco products. The continued decline in route trade businesses and mixed businesses is likely to see some reduction in the extent of choice customers have and potentially some further concentration of cigarette and tobacco sales amongst supermarkets and grocery stores.
- A significant proportion of retailers are concerned that the impacts of recent (and proposed) regulations to limit the display of cigarette and tobacco products have not been adequately evaluated by Governments to ensure accurate assessment of the likely effects. Consequently, retailers generally seek the completion of further research and analysis to better understand the probable impacts of display regulations on their businesses.
- A key development in the structure of the retail industry over the past decade has been the growth of convenience stores, with these now comprising a substantial component of the retail industry. These convenience stores rely relatively more heavily on sales of cigarettes and tobacco products, with more than a third of their sales generated from these goods.
- The sale of cigarettes and tobacco products in convenience stores is often associated with the sale of ancillary products (eg bread and milk), and the combined impact of such sales results in a significant contribution to the profitability of these stores.
- Each type of retail business tends to implement different sales strategies. For example, supermarkets and tobacconists typically offer higher discounts to increase sales but this approach results in lower gross margins. By contrast, other retailers mainly sell single packets of cigarettes at the full recommended retail price, thereby achieving high gross margins per packet.

- Smaller retailers, such as mixed businesses, are likely to be pressured to reduce the hours worked by employees or the number of staff if further legislation reduces their sales and margin. There are also risks of adverse impacts on smaller population centres where the traditional mixed business store is a significant source of goods and associated services.
- The ability of illegal tobacco (or 'chop chop') suppliers to offer significantly lower prices compared to the legal product means that there is generally very strong demand for this product. Tax avoidance (especially excise and GST), allows 'chop chop' to be offered from under the counter to customers at substantial discounts. Further restrictions precluding the display of cigarettes and tobacco products may increase the volume of illegal tobacco, as the distinction between legal and illegal products becomes blurred.

Appendix 1: Organisations consulted for this Study

PricewaterhouseCoopers thanks all those who have contributed their time and expertise to making this project possible:

Organisation
AC Nielsen
Australian Association of Convenience Stores
Australian Hotels Association
Australian United Retailers
British American Tobacco Australia
Clubs ACT
Free Choice Tobacconist Store Group
Independent Grocers of Australia
Independent Grocers of Australia (WA)
Independent Retail Association (WA)
Liquor Store Association NSW
Liquor Store Association Victoria
National Association of Retail Grocers of Australia
NSW Clubs Association
NSW Retail Tobacco Traders Association
Queensland Newsagents Federation
Queensland Retail Traders and Shopkeepers Association
(The) Retail Confectionery & Mixed Business Association
Retail Traders Association of NSW
Service Station Association
State Retailers Association of South Australia
Tasmanian Independent Wholesalers
United Star Supermarkets
Victorian Association of Newsagents