



January 2017

The General Manager
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
CANBERRA ACT 2601
adjudication@accc.gov.au

Re: A91550 – British American Tobacco - submission

To whom it may concern,

On behalf of members of the Australasian Association of Convenience Stores (AACCS), the peak body for the convenience industry in Australia, we make the following submission to the Australian Competition and Consumer Commission (ACCC) in response to the draft determination made in relation to authorisation A91550.

The AACCS supported the application for authorisation prior to the draft determination and we now strongly urge the ACCC to reconsider its position.

There is considerable public benefit in permitting the Applicants to work together to identify, issue warning notices and, if necessary, to cease supply of tobacco products to retailers and wholesalers who sell illicit tobacco products.

Further, AACCS members are in a unique position to provide a real world perspective of the potential benefits of authorisation in terms of improved competition and community safety.

We are of the firm belief that the net public benefit of authorisation would be overwhelmingly positive.

Illicit tobacco products are by their very nature non-compliant with safety and quality standards. Those who sell these products do not do so responsibly, nor do they pay their rightful excise on tobacco products. The greater the proportion of illicit tobacco in the total tobacco market, the greater chance these non-compliant products will end up in the possession of minors.

In this submission, the AACCS outlines briefly some actual examples that demonstrate the prevalence of illicit tobacco in Australia and the ease with which consumers of all ages, including minors, can access these products.

We also include details of independent research conducted in September 2016 by Sexton Marketing Group which investigated Australians' opinions toward illicit tobacco. The survey is the most comprehensive research ever undertaken in Australia on the topic of illicit tobacco and involved 4,000 Australians aged 18 and over, each enrolled to vote in State and Federal elections.

We strongly urge the ACCC to consider these recent, real life examples, as well as the research we have summarised in this submission, in determining what constitutes net public benefit with regard to the proposed authorisation.

As an addendum to this subsequent submission, we also provide the ACCC a copy of our original September 2016 submission for its ongoing reference in coming to a final determination.

Application for authorisation A91550 has the potential to play an important role in a coordinated approach from Government, industry and law enforcement authorities to crack down on the illicit tobacco market in Australia.

The AACS welcomes the opportunity to provide our unique perspective on this issue as the adjudication process progresses. Please don't hesitate to contact me should you require anything further.

Jeff Rogut FAIM MAICD
Chief Executive Officer
Australasian Association of Convenience Stores Limited
ACN: 156 638 023

Mobile: 0467 873 789
Office: 03 9807 5552
email: jeff@aacs.org.au
Website: www.aacs.org.au

Mail: PO Box 2309,
Mt Waverley,
Vic. 3149
Australia

About the AACS

The Australasian Association of Convenience Stores (AACS) is the peak body for the convenience industry in Australia.

Nationally, our industry employs over 40,000 people in over 6,000 stores. The majority of these stores operate as family run businesses, often under licence or franchise agreement, or independent ownership. They regularly employ family members and people from the local communities in which they operate.

The AACS represents the interests of these small businesses; their owners, staff, suppliers and customers.

The convenience industry in Australia was valued at approximately \$18 billion in 2015 according to companies contributing to the *2015 AACS Annual State of the Industry Report*. This report contains the most comprehensive information available on the convenience industry in Australia and we would be happy to provide a copy.

As an Association we enjoy strong ties with our international counterparts including the convenience stores associations in the US, Canada, the UK and New Zealand. We also visit similar stores in South East Asia to keep abreast of changing or emerging trends.

Recent case studies

Australians are becoming more and more aware of the extent of the illicit tobacco trade in Australia due to the high profile nature of large scale contraband seizures at our borders, and the attention drawn to the issue by authorities such as the Australian Federal Police.

However the actual impact of the illicit tobacco market on the competitiveness of individual small businesses is not well understood.

The following case study involves the individual Ballarat franchisee of an AACS member with multiple stores operating, largely in Victoria and NSW.

Increasingly concerned by the incidence of illicit tobacco being sold in the local area, the franchisee physically enquired as to the availability of illicit tobacco at numerous retail outlets within immediate proximity of his own premises.

The business owner was offered for sale illicit tobacco products (not in plain packaging and not complying with graphic health warning requirements) at four separate retail outlets in the vicinity of his own store.

In the franchisee's own words:

These outlets have cost my business \$120,000 in retail sales and \$18,000 in profit, including the \$6,000 I spent reducing my margin between January and July. There is also the royalty cost to [BUSINESS NAME WITHELD] of an additional \$12,000. This is a significant cost of just one affected business.

While the Border Force Tobacco Strike Team asked the affected business owner to provide a victim impact statement after being informed of this situation, it's clear that action is needed by additional parties and authorities to stem the illicit tobacco trade.

Authorisation A91550 represents a willingness on behalf of the industry to play its role.

A personal account

As AACS CEO, our many members nationally have made it very clear to me how prevalent illicit tobacco is in communities nationally. Earlier this year I decided to personally test how easy it was to purchase illicit tobacco at a local market in Melbourne.

Illicit tobacco – branded and without health warnings – was readily available from multiple outlets at prices well below typical retail prices for legal tobacco products. The brazen nature with which market operators were willing to offer illicit products, seemingly without fear of consequence and certainly without any attempt to implement age restriction requirements, was alarming.

Illicit tobacco is readily and widely available in the community for purchase by consumers of all ages from many different retail outlets without even requesting proof of age.

For this reason, we strongly believe authorisation A91550 be granted to the Applicants as part of a coordinated effort to crack down on the illicit trade of tobacco.

Research summary: Public opinions on illicit tobacco

In 2016, the AACS commissioned independent research to investigate the level of public awareness, as well as attitudes and opinions, on the illicit tobacco market in Australia.

A total of 4,000 Australian consumers aged 18 years and over (and eligible to vote in State/Territory and Federal elections) were interviewed in late August / early September 2016, using a combination of online and telephone interviews.

The survey and subsequent independent research report was undertaken and compiled by the Sexton Marketing Group.

Executive summary

- The research shows that the biggest single consumer concern regarding illicit tobacco is that *it is a revenue-earner for organised crime, who use that revenue to expand their criminal activities, including into socially damaging areas like ice production and distribution.*
- Consumer awareness of the extent of the illicit tobacco trade is generally low.
- Most consumers would be concerned if politicians turned a blind eye to this issue, or worse still, did not adequately resource Customs to stop the trade at its source.
- There is also strong support for tougher penalties for illegal tobacco trafficking and unscrupulous retailers selling illegal tobacco products.
- There is also concern that Government revenue is being lost, putting pressure on budgets for hospitals, schools, etc.

Consumers want non-compliant retailers punished

Unsurprisingly, the research shows that consumers are strongly in favour of penalising unscrupulous retailers which sell illicit tobacco. Authorisation A91550 is focused specifically on tougher penalties in line with public opinion on this issue.

A summary of the key findings of the AACS research into public opinions on the illicit trade of tobacco is included overleaf.

For a detailed briefing of the full research report, contact AACS CEO Jeff Rogut at jeff@aacs.org.au

22%

Of Australian smokers have been offered
illegal or illicit tobacco products

54%

Believe illicit tobacco needs Govt action

77%

Of consumers are concerned that crime
syndicates use profits from illegal tobacco to expand other criminal
activities including illicit drugs like ice

85%

Of consumers believe there should be much
tougher penalties for illegally importing tobacco

81%

Of Australians believe there should be much
tougher penalties for selling illegal tobacco products in retail shops

58%

Of consumers are extremely or very concerned
about the impact of illicit tobacco on retailers of legal tobacco

AACS SUBMISSION RE: AUTHORISATION A91550, SEPTEMBER 2016

Executive summary

In this submission the AACS highlights the prevalence of illicit tobacco in Australia, the impact of this illegal market on the convenience industry, and its reasons for supporting the application for authorisation.

Below is a snapshot of the status of the legal and illegal tobacco markets from the convenience industry perspective.

- Legal tobacco products represent a significant proportion of total convenience store sales in Australia. According to the most recent AACS State of the Industry¹ report, on average over 37% of a typical convenience store's sales and 25% of a store's gross profit comes from legal tobacco.
- Since the introduction of plain packaging for tobacco products in Australia in December 2012, the dollar volume of legal tobacco sold in our channel has remained stable. This is because of the tax increases placed on legal tobacco.
- However convenience stores have suffered as a result of an increase in the illicit trade of tobacco, with the volume of tobacco sold reduced. Increased product handling errors and increased labour and inventory management costs are other side effects of plain packaging.
- Awareness among small retailers in Australia of illicit tobacco is high and has increased since the introduction of plain packaging. Customers are aware of illicit tobacco and some are actively seeking it out.
- As at October 2015, the illicit tobacco market was estimated by KPMG² to account for 14.3% of total tobacco consumption nationally in the 12 months to June 2015.
- Sold legally, this would have generated an extra \$1.42 billion in tax revenue for the Australian Government.
- Recent high profile seizures of illegal tobacco have reinforced the enormity of the illicit tobacco market in Australia.

AACS strongly supports the authorisation application

The AACS believes authorisation will be of public benefit and will have no negative impacts on competition in the legal tobacco market.

¹ *The AACS State of the Industry Report 2015*

² *Illicit Tobacco in Australia 2015 Half Year Report, KPMG*

The proposed arrangement has the potential to reduce the amount of illicit tobacco contributing to the total tobacco market. It will also increase the likelihood of retailers and wholesalers caught selling illegal tobacco products to face penalties.

Illicit tobacco is by its very nature non-compliant with safety and quality standards and is much more likely to end up in the possession of minors. Therefore the public benefit is clearly served by the authorisation from the Applicants being granted.

The AACS believes there are no negative impacts on competition in the authorisation being granted.

The Applicants themselves are otherwise in direct competition in the legal tobacco market. Only the criminals involved in the production, smuggling and distribution of illicit tobacco, as well as the retailers and wholesalers who sell these illegal products, stand to lose out.

The illicit tobacco market in Australia

The latest independent research from KPMG into black market tobacco consumption in Australia shows that illegal tobacco represented 14.3% of total consumption as at October 2015. Sold legally, this would have generated an extra \$1.42 billion in tax revenue for the Australian Government.

It robs honest retailers of legal tobacco sales. Responsible retailers of legal tobacco are bearing the brunt while the illegal tobacco market has grown significantly in recent years.

It is a disturbing trend that demonstrates the unintended consequences of poorly planned Government policy, as the criminals who supply these illegal tobacco products don't care if it ends up in the hands of minors. There are also no quality checks on what is actually in the products.

The Australian regulatory environment continues to contribute to our growing reputation as one of the world's most lucrative markets for illegal tobacco.

Legal tobacco remains an important product for small businesses and the more the market for illicit tobacco expands, the more these small businesses will suffer. Consider the quote below from an actual retailer – and small business owner – on the impact of illicit tobacco on a typical convenience store:

“My conservative estimates are that illicit tobacco is costing my business at least \$200 per day in tobacco and associated sales. My decline in customer count traffic commenced when the (nearby) illegal outlet opened in February this year.

“Not only is this having an adverse effect on my business profitability, but it's also costing [brand withheld] Service Stations nearly \$10K per year in lost revenue and supplier rebates.”

The point is clear: the illicit trade of tobacco is having a pronounced negative impact on small businesses around Australia. Illicit tobacco is widely and readily available through many unscrupulous sources. The need to target the illicit tobacco market is urgent.

Targeting the illicit tobacco market

The illicit tobacco market robs legitimate businesses of sales and market share and Governments of its entitled revenue from the sale of tobacco.

A coordinated effort to crack down on the illicit trade of tobacco is perhaps the most obvious and effective measure to reduce the incidence of smoking, particularly among minors, while ensuring those who are licensed to sell a legal product are not negatively impacted.

The authorisation is one component of the coordinated approach required.

A hotline for retailers and consumers to alert authorities to the illicit trade of tobacco could also be established.

This would provide a low cost avenue for any retailer or consumer approached by an individual or group to purchase illicit tobacco products to assist police in targeting the criminals involved in the illicit market.

The loss of revenue to the Commonwealth arising from the consumption of illicit tobacco products

It's well known that excise from legal tobacco sales is a significant contributor to Government revenue.

What isn't as widely known is that the revenue the Government is missing out on because of the huge spike in illicit tobacco trade has run into the billions of dollars annually.

As at October 2015, the illicit tobacco market was estimated by KPMG² to account for 14.3% of total tobacco consumption nationally in the 12 months to June 2015.

Sold legally, this would have generated an extra \$1.42 billion in tax revenue for the Australian Government.

The involvement of organised crime in the illicit tobacco market in Australia

Criminal gangs are proven to be very effective in filling gaps in the legal tobacco market.

According to research from leading international research company Roy Morgan entitled *The Impact of Plain Packaging on Australian Small Retailers*³, commissioned by Philip Morris and supported by the AACS and other retail associations, a third of retailers reported having had customers enquire about purchasing illicit tobacco from their outlets.

The public is well aware of the existence of illicit tobacco in Australia and are actively seeking it out, driven in part by the high cost of legal tobacco.

The Roy Morgan research also shows that awareness among small retailers in Australia of illicit tobacco is high and has increased since the introduction of plain packaging. More than four in ten retailers perceive illicit trade to be having a negative impact on their business.

The growth of the illicit market, combined with excessive taxation increases and plain packaging legislation, has resulted in a shift in consumer purchasing habits when it comes to tobacco.

Consumers are now driven predominantly by price as brands have been diminished, and adult consumers are increasingly looking at illicit products as tax hikes on legal tobacco continue to have a dramatic impact on price.

³ *The Impact of Plain Packaging on Australian Small Retailers*, Roy Morgan, 2013

Of course, illicit products are much more likely to end up in the possession of minors, as these products by definition are not sold responsibly.

The effectiveness of existing legislation

Recent high profile seizures of illegal tobacco have reinforced the enormity of the illicit tobacco market in Australia.

The unprecedented spike in the illicit tobacco market coincides directly with the introduction of plain packaging legislation and the most recent round of excise increases applied to legal tobacco products.

It's important to understand that tobacco itself is, despite being more expensive in Australia than almost anywhere else in the world, actually a low margin product for retailers. The tax consumers pay on tobacco is what contributes to its high price and these high prices make Australia a particularly attractive market for criminals to sell illicit tobacco.

Illegal tobacco is by its very nature non-compliant with restricted sale and packaging requirements, and criminals have no issue selling illicit tobacco products to minors.

Existing regulations surrounding the sale of legal tobacco are not working. They are pushing otherwise law abiding consumers to the illicit market, and they are positioning Australia as one of the world's most lucrative markets for illegal tobacco.

Legal tobacco is an extremely important product for convenience stores. Though it is low margin, it still represents a considerable proportion of sales and is a key reason for consumers to visit our members' stores.

The rise in the illicit tobacco market is hurting small businesses especially, as the major supermarket chains are much better positioned to absorb the regulatory costs and the loss of trade to the black market through their many other product categories and buying power.

Conclusion

The AACS, as the representative and voice for convenience stores across the country, emphasises the significant negative impact that the sharp rise in illicit tobacco trade in Australia continues to have on small retailers.

More than four in ten retailers perceive illicit trade to be having a negative impact on their business, and a third report having had customers enquire about purchasing illicit tobacco.

Recent large scale busts in Australia highlight the demand for, and prevalence of, illegal tobacco.

The huge growth in illicit tobacco sales is concerning for all. Police in Australia have made major seizures of illicit tobacco and worryingly, it is quite easy to buy non-compliant tobacco.

This impacts honest retailers who sell tobacco responsibly and legally as well as the Government, which experiences a significant loss of revenue because the sale of illicit tobacco circumvents the tax otherwise payable on legal tobacco products.

The AACS believes a coordinated effort from Government, industry and law enforcement authorities is necessary to effectively crackdown on the illicit tobacco market in Australia.

The application for authorisation is a key component of the coordinated effort required and the AACS therefore strongly supports the application.

Thank you for your consideration of our submission.

Jeff Rogut FAIM MAICD
Chief Executive Officer
Australasian Association of Convenience Stores Limited
ACN: 156 638 023

Mobile: 0467 873 789
Office: 03 9807 5552
email: jeff@aacs.org.au
Website: www.aacs.org.au

Mail: PO Box 2309,
Mt Waverley,
Vic. 3149
Australia