Overview of the New Zealand retail sector

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This article provides an overview of the retail sector over the past five years. Strong sales growth across all store types has been a key feature of the retail sector over the period. The scale of the retail sector has also been expanding, with a significant increase in the number of new stores, and a tendency toward larger store sizes as operators seek competitive advantages of increased buying power and other scale economies. Low price inflation, particularly for stores that sell imported goods, has been another feature of the retail sector; low or negative inflation in the sector has been driven by the rising New Zealand dollar, and a fall in world prices for manufactured consumption goods. Productivity growth within the retail sector appears to have been lower than in other parts of the economy, but may be increasing over time. Profit margins within the sector have lifted slightly over this period but appear to have been constrained by strong competition and further increases in capacity within the sector.

1 Introduction

The retail sector is an important part of the economy, acting as a channel for a large component of household consumption, and spending by international visitors. The aim of this article is to provide an overview of trends within the retail sector since 1999.

A key finding is the strong sales growth within the sector over the past five years, with sales lifting by nearly 30 per cent. This represents a significantly stronger rate of growth than for many other sectors of the economy.[1] At the same time, there has been an increase in the overall size of the retail sector, with a movement towards larger stores and retail chains at the expense of smaller merchants. This reflects an international trend, with increased buying power and scale economies potentially adding to growth.

Price inflation is another feature of the retail sector that is strongly influenced by international trends. Very low, or negative, rates of inflation are evident in stores selling imported goods, or substitutes for imports; the ongoing fall in import prices a result of a fall in world prices and the rising exchange rate.

Productivity growth within the retail sector has been relatively modest. Increases in retail sector capacity may have suppressed productivity growth for the sector as a whole, as sales growth is spread over an increasing number of operators. Profit levels within the sector have followed this general trend, with profit margins lifting only modestly.

The main source of information for this article is Statistics New Zealand's Retail Trade Survey. As shown in table 1 (a summary of retail sector sales and prices) this survey covers 24 separate sub-sectors of retailing. These sub-sectors include accommodation, cafes and restaurants, motor vehicle retailing, repairs, and fuel. The inclusion of these particular sub-sectors is in contrast to many countries, where some or all of these areas are excluded from statistics on the retail sector. When discussing the New Zealand retailing sector, it is quite common to quote retail statistics excluding the motor vehicle sector, owing to the relatively volatile nature of both sales and prices.[2]

2 Retail sector sales

Strong growth has been evident in the New Zealand economy since 1999, the time of worldwide recovery from the 1997 Asian crisis. This recovery was mirrored by the New Zealand retail sector. As shown in figure 1 total retail sector sales have grown by an average annual rate of between 4 and 8 per cent since 1999. With price inflation in the sector averaging just 1.3 per cent, there has also been substantial growth in the volume of sales (ie the number of units sold). Overall there has also been a substantial rise in per capita sales (see figure 2, p. 34).

1 Growth in retail sector GDP has averaged 4.5 per cent since 1999, compared to 3.9 per cent for all industry GDP. Growth is measured as a per cent change from the same quarter of previous year.

2 Calculations that exclude motor vehicle retail will be noted.

Box 1: Key Facts

- Prices of imported consumer goods have fallen steadily over recent years, and in 2004 were about 12 per cent lower than five years earlier.
- Around 15 per cent of New Zealand's business enterprises are classified as retail outlets, according to the business demography statistics published by Statistics New Zealand.
- As at December 2004 the retail trade sector accounts for about 19 per cent of total employment.
- Retail sector activity represents 7.5 per cent of total GDP, with sales of around $51 billion in 2004.[3]
- Supermarket and grocery stores are the largest store type in the retail sector, accounting for around 28 per cent of all ex-auto retail sales over the past six years. Department stores and cafes and restaurants are the second largest store types, each with an 8 per cent share of total sales.
- The supermarket and grocery store type employs 16 per cent of retail sector employees.
- Auckland has the greatest geographical share of sales, accounting for 34 per cent of total retail sales.
- An estimated 20 per cent of retail sales are directly imported.
- Inflation in the retail sector has averaged around 1.3 per cent across stores other than automotive sales, repairs, and fuel over the past five years.

Table 1

Retail sector annual sales and price movement (2004)

	Sales ($million)	Per cent of total	Annual growth in 2004	Average annual growth since 1999	Price movement in 2004	Average annual price movement since 1999
Supermarket and Grocery Stores	11,255	20.4	7.1	6.19	0.8	2.3
Motor Vehicle Retailing	8315	15.0	6.0	5.90	-2.8	-0.7
Automotive Fuel Retailing	4450	8.0	17.8	5.88	9.6	5.5
Department Stores	3351	6.1	5.0	8.13	-1.7	0.4
Cafes and Restaurants	3043	5.5	7.4	8.13	2.8	2.9
Other Retailing	2496	4.5	0.3	5.13	1.9	2.9
Accommodation	2210	4.0	9.4	5.30	4.3	2.4
Clothing and Softgoods Retailing	2130	3.9	9.9	7.22	-0.4	0.8
Recreational Goods Retailing	2117	3.8	6.9	5.37	-0.1	1.5
Appliance Retailing	2110	3.8	8.9	7.56	-7.3	-3.9
Automotive Repair and Services nec	1654	3.0	3.6	10.00	3.8	3.7
Chemist Retailing	1543	2.8	13.2	5.02	1.8	0.3
Other Personal Services	1469	2.7	13.2	7.32	2.5	2.6
Furniture and Floor Coverings	1354	2.4	7.3	5.25	-0.3	1.9
Auto Electrical, Smash Repair, Tyres	1346	2.4	11.0	6.59	1.4	2.1
Hardware Retailing	1106	2.0	11.3	6.66	-0.5	1.3
Bars and Clubs	1091	2.0	2.7	2.44	3.8	2.9
Liquor Retailing	986	1.8	5.9	0.87	3.3	2.4
Takeaway Food Retailing	886	1.6	13.4	7.19	2.4	2.5
Fresh Produce Retailing	816	1.5	5.5	9.20	0.8	3.4
Other Food Retailing	732	1.3	14.7	5.73	1.5	2.2
Footwear Retailing	317	0.6	11.9	5.17	-2.4	0.2
Household Equipment Repair Services	306	0.6	-2.1	7.42	-0.7	1.4
Personal and Household Goods Hiring	206	0.4	13.0	9.35	1.1	1.4
Ex-Auto TOTAL	39,521	70	7.4	6.2	0.02	1.34
TOTAL	55,287	100	7.9	6.2	0.35	1.33

[3] The data are for the year to September 2004.

Figure 1

Retail sector sale

(annual average percentage change)

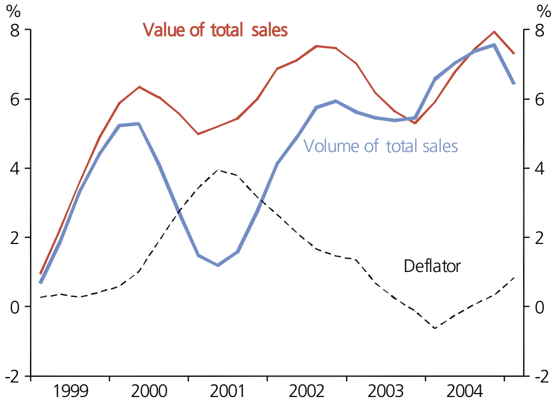
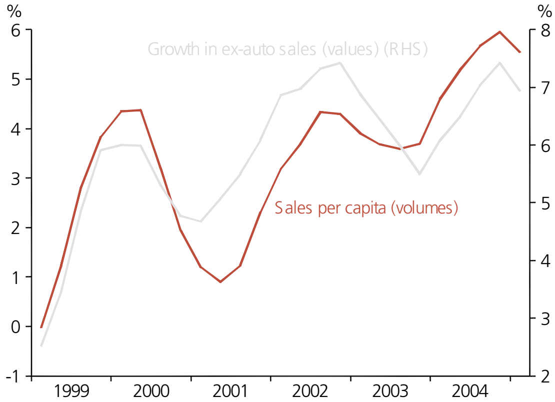


Figure 2

Retail sales per capita

(annual average percentage change)



Activity in the retail sector tends to reflect trends in the economy at large – given a strong connection between retail demand, employment, and incomes. Strong population growth over the period from 2001 to 2003, due to record levels of net immigration, appears to have fuelled demand in the retail sector with the associated rise in labour supply more than matched by growth in labour demand (figure 4). Consequently, employment has increased, adding to household sector spending power.

High net immigration provided an initial stimulus to the housing market, as new immigrants settling in New Zealand sought out accommodation. In addition, existing residents increasingly participated in the buoyant housing market, adding to the demand for both new and existing homes and providing a particular source of strength for the retailing sector. With an estimated 65,000 new residential building consents issued between 2002 and 2004 alone, the boost to demand for housing-related retail goods has been considerable. As new houses are built, and the turnover of the existing housing stock increases, the demand for new appliances, furnishings, and related goods will increase (see figure 5).

Increased tourist numbers have also had a strong impact on the retail sector, particularly in hospitality-related areas. Record numbers of overseas visitors throughout 2002 and 2004 supported the high levels of retail sales growth over

Box 2

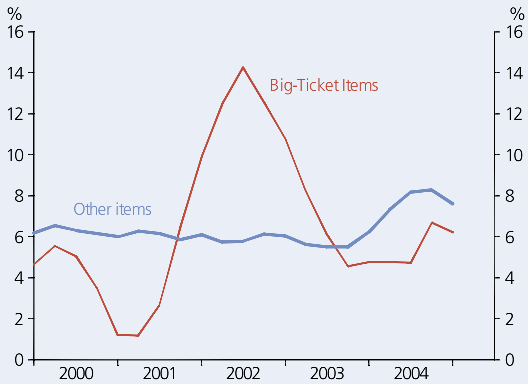
Retail sales by store type

Spending in retail stores can be broadly classified into two categories: big-ticket items, including furniture, appliances, and motor vehicles, and other spending that includes both necessities, such as food, and other discretionary items. As shown in the above figure, expenditure on big ticket items is typically subject to larger cyclical movements. Traditionally, big-ticket sales are income-elastic and are, therefore, determined largely by the economic cycle. Over the past five years we see periods in which consumers splurge on big-ticket items as a result of increased consumer confidence and household wealth. In contrast we see a relatively flat growth rate for discretionary and necessity goods, as these goods are more income-inelastic. Rates of growth in sales of these goods have remained high, underpinned by population growth and a buoyant housing market.

Figure 3

Growth in big-ticket and discretionary items

(annual average percentage change)



this time. In the first half of 2003 a substantial decline in visitor arrivals, as a result of the impact of the war in Iraq and the SARS crisis interrupted this trend. This downturn in tourist numbers is shown in figure 6.[4]

Growth in retail sales from 1999 was initially supported by strong growth in export incomes. A falling exchange rate from about 1999, combined with strong world commodity prices, saw a sharp rise in export incomes over 2000–2001. Consequently, the strong growth in retail sales evident in urban areas of New Zealand was also matched by growth in sales in many rural areas (figure 7). Growth in rural incomes has slowed since 2002, as the New Zealand dollar has increased, but much of the momentum in sales growth appears to have remained, with retail sales growth recently accelerating in some rural economies.

Figure 4
Population net migration and annual growth in retail sales

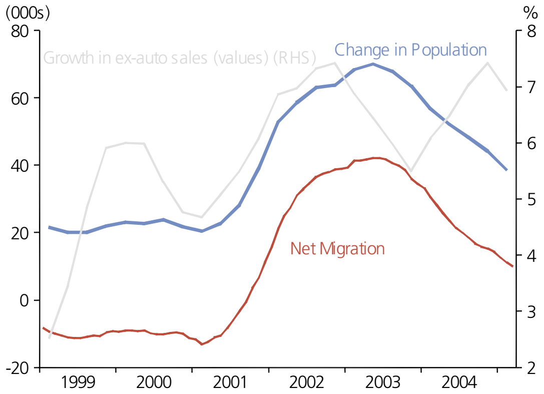
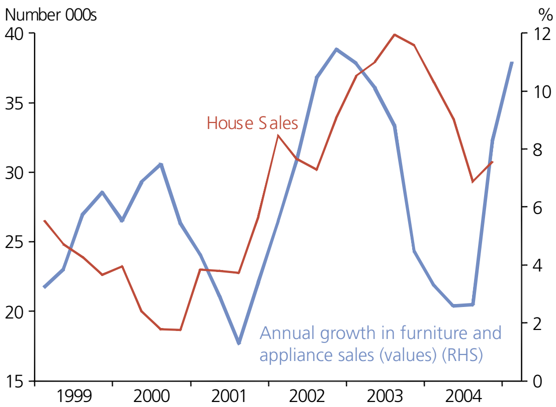


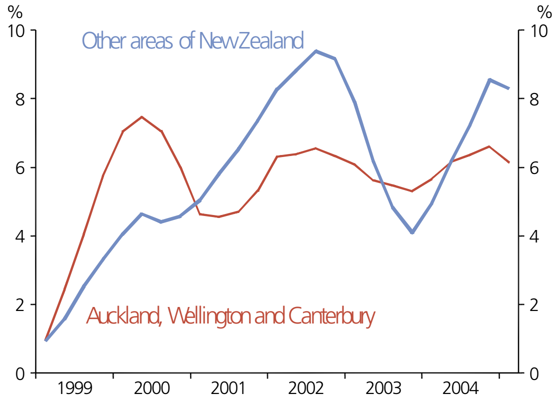
Figure 5
Furniture and appliance sales



[4] The sharp decline in mid 2001 may be due to the impact of the US September 11 terrorist attacks. This seemed to have a smaller impact on retail sales when compared to the SARS crisis in 2003.

Figure 6
Visitor numbers and annual revenue growth in the hospitality sector

Figure 7
Regional sales growth
(annual average percentage change)



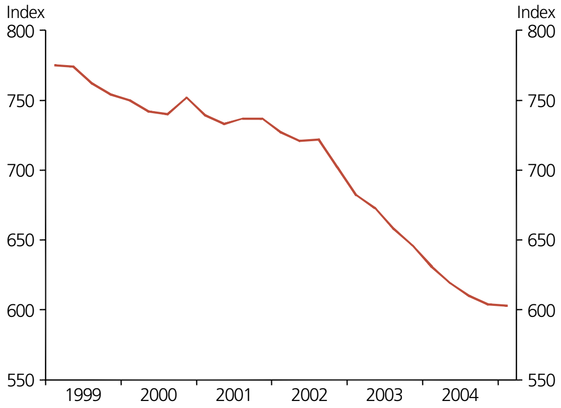
3 Retail sector prices

Over the past five years, the retail sector has displayed lower rates of price inflation when compared to other sectors of the economy. Between 1999 and 2004, prices across all areas of the retail sector rose by an average of around 1.3 per cent per annum, while inflation in the Consumers Price Index averaged around 2.5 per cent over the same period.

However, across the different categories of retailing, pricing trends have varied considerably, as shown in table 1. Low or negative rates of inflation have been seen in many store-types selling imported goods, or goods competing directly with imports. Examples include appliance, footwear, hardware, department stores, and motor vehicle retailing. The most striking example is appliance retailing, where

Figure 8
Price deflators for appliance retailing and component goods.

(a) Appliance retailing



(b) Components of 'appliance' retailing; Television and Video, Audio and Electrical accessories and fittings.

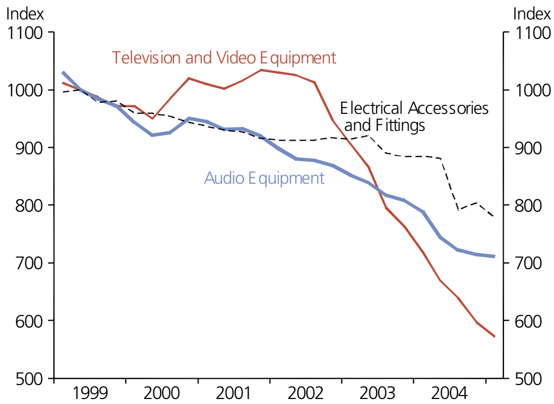


Figure 9
Prices of imported consumer goods

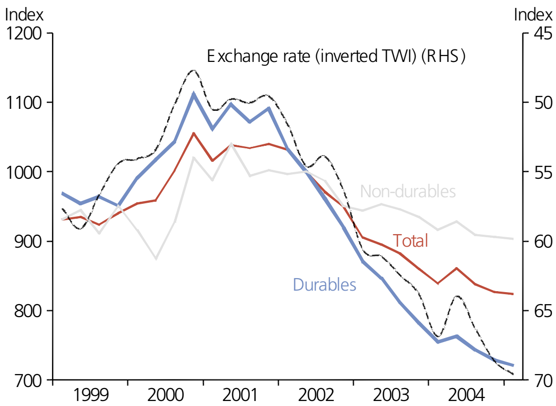
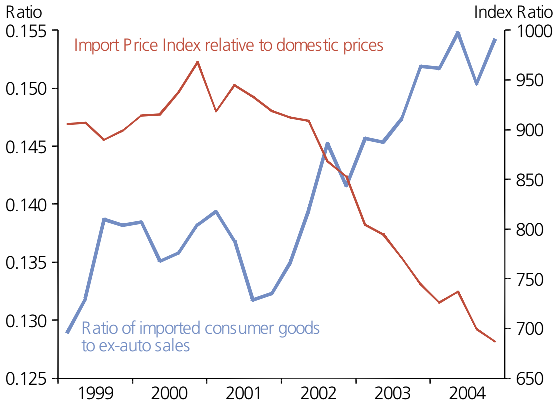


Figure 10
Import to sales ratio



prices have dropped by almost 4 per cent per annum on average over the past five years (figure 8).

Throughout much of this period, a rising New Zealand dollar has placed considerable downward pressure on import prices for consumer goods, as is shown in figure 9. The world prices of manufactured retail goods also appear to have fallen significantly, placing further downward pressure on import prices. The ongoing fall in import prices has contributed to an increase in the share of imports in retail sales (figure 10) with demand apparently switching toward these cheaper products.

However, the exchange rate and intense competition may not have been the only factors helping to keep prices low in parts of the retail sector. Other influences include the following:

- Retailers have actively continued to source cheaper goods from overseas suppliers in an effort to keep prices low. This activity is reflected in the increasing significance of imports from some countries such as China. From 2000 to 2004, imports from China increased from 8 per cent to 10 per cent of total imports. Much of this increase was made up of electrical goods.
- Product life cycle effects may also be playing a role in suppressing prices in parts of the retailing sector. For example, television and video equipment prices have plummeted in recent years, falling by about 40 per cent since 1999 (figure 8 (b)). This is well in excess of reductions that may have been expected due to

the exchange rate. These price falls often occur as technology matures and the costs of production fall.

Although prices have been falling in some areas of retailing, increases have been evident in other areas. Rising oil prices have contributed to substantial increases in prices within automotive fuel retailing, where prices have risen by an average of 5.5 per cent since 1999. Other parts of retailing with relatively high rates of inflation include accommodation, liquor, bars and clubs, cafes and restaurants. Since these sectors have little direct reliance on imports, prices will have been relatively unaffected by the rising exchange rate. Stronger activity levels and a tightening labour market are likely to have contributed to higher prices. Occupancy rates have lifted consistently in the accommodation sector since 2000, buoyed by stronger demand from domestic and international tourists, which is likely to have been accompanied by some increase in prices.

4 Size and scale of the retail sector

Against the backdrop of strong sales growth, the overall size of the retail sector has been expanding in recent years. Hours worked have grown rapidly (see figure 11) and significant numbers of new stores have opened.

Statistics New Zealand's business demography statistics suggest more than 4,500 new retail stores have opened since 2000, an increase of almost 10 per cent. Some of these stores represent expansions by existing operators (largely chains), while others will be new entrants to the industry.

Figure 11
Growth in hours worked in the retail sector.
(annual average percentage change)

The data also suggest that retail stores are, on average, becoming larger over time (table 2). Scale is a relatively complex variable to measure comprehensively, and data in this area are limited. However, between 2000 and 2004, the average number of persons employed per retail store increased from 5.5 to 5.8.[5] Although this might at first not appear a dramatic increase, it would suggest that retail stores have become 7 per cent 'larger' on average (taking average employment per store as a very rough proxy for store size).[6] These numbers imply that the capacity, or scale, of the sector has grown significantly since 2000 (ie by over 15 per cent). The increase in capacity would be consistent with claims sometimes made by retailers that an increased volume of retail sales has had to be shared across a growing pool of operators and larger stores, in some cases leading to a fall in sales on a same store, or square metre, basis.

The trend toward larger stores reflects international trends, and there are a range of drivers. Many retail operators are likely to have been seeking competitive advantages in the form of greater buying power from suppliers, and scale economies in areas such as staffing and advertising. Some stores recently established in New Zealand have been part of companies operating in Australia or further afield, and may have been able to leverage further competitive advantages from their international presence. Consumer preferences also continue to drive the shift towards larger stores and shopping centres, seeking the added convenience of factors such as on-site parking, as well as a greater range of products, and lower prices.

Statistics New Zealand data on non-residential building activity bears out the significant expansion in retail sector capacity in recent years. The number of building consents issued for shops, restaurants, and taverns has grown at an

[5] If we remove 'Accommodation, Cafes and Restaurants' from the calculation, the size of retail stores alone has increased by 10 per cent on average over the same period. More detailed data also confirms that Hardware, Department Stores and Footwear have exhibited the biggest increases in employment per store.

[6] Detailed data from the business demography directory show that there has been substantial growth in the number of larger sized stores, with stores with more than 10 employees having increased sharply over the past few years.

Table 2

Structure of the New Zealand retail sector (including accommodation)

	No. stores with less than 10 employees	No. of stores with more than 10 employees	Average number of employees per store	Total number of stores
2000	43297	6537	5.5	49834
2004	46387	8021	5.8	54408
% change	7.1	22.7	7.2	9.2

annual average of 16.8 per cent since mid-2002. Much of this building activity has been evident in the refurbishment and expansion of shopping centres throughout New Zealand. Substantial new investment in bulk retail stores continues, including a $50 million shopping complex currently under construction in Hamilton, as well as other areas of the country. Much of the demand for new retail space is purportedly from Australian retailers looking to enter or expand their operations in New Zealand.

5 Labour productivity

Given the strong growth in sales and ongoing structural changes, it is useful to investigate how labour productivity in the retail sector has evolved over recent years. To what extent have the high rates of sales growth been matched by increases in output per worker? Answers to this question can help shed light on the competitiveness and profitability of the retail sector.

Labour productivity can be measured by dividing the retail sector component of GDP – which measures valued-added in retailing – by hours worked.[7] As a measure of hours worked we use the Quarterly Employment Survey (QES) estimate of hours paid. This data is sourced directly from administrative records of firms, and allows us to isolate hours paid in the retail sector, from hours paid in the wholesale sector.[8]

The resulting calculation suggests that growth in retail sector productivity has been rather weaker than growth in productivity for the economy at large. Over the period from 1990 to 2004, productivity growth rates average 0.1 per cent per annum for the retail sector, compared to 1.1 per cent per annum for the total economy (see Figure 12 and table 3).[9] While there is an indication that productivity is increasing over time, this result should be taken with caution due to the arbitrary nature of the break and the volatility of the series.

One explanation for the weaker productivity growth rates in retailing, at least for the earlier period in table 3, may be the significant expansion of opening hours that occurred in retailing during the 1990s. With many stores moving to seven day opening and extended opening daily hours (driven by legislative changes and customer demand), sales achieved per worker may have come under pressure. This explanation would be consistent with the transition to faster productivity growth rates later in the period.

Another explanation for lower rates of measured productivity growth may be that increases in retail sector capacity (due to the entrance of new operators and stores) have acted to suppress productivity growth for the sector as a whole. Although retail sales have been growing rapidly, the growth in sales has been spread across a larger pool of retailers.

It can be argued that there is less opportunity for capital deepening (greater use of plant and equipment) in the retail sector when compared to other sectors of the economy. Retailing is inherently a relatively labour intensive activity,

7 We use GDP as it measures the real service provided by retailers in the provision of transactions to customers. This is in contrast to using total sales, which is simply the total value of the goods sold. An ARIMA trend has been used to smooth the series.

8 The Household Labour Force Survey (HLFS) estimate of hours worked, used in recent work on productivity at The Treasury, compiles data for the wholesale and retail sectors as an aggregate.

9 Retail sector productivity improves significantly when accommodation, restaurants and bars are removed from the measure. The low productivity of the hospitality sectors is the direct result of the labour-intensive nature of this industry.

10 In a recent report by the OECD the ratio of physical capital to total employment was found to be lower in the 'retail trade and wholesale, hotels and restaurants' sector when compared to other service industries for all OECD countries. (Wölfl, Anita (2005) "The Service Economy in OECD Countries" STI Working Paper, OECD.)

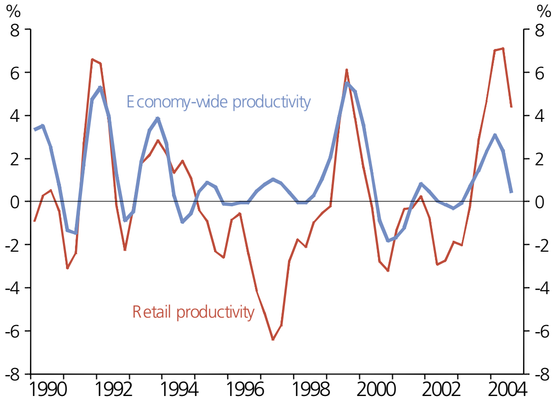
Table 3

Average labour productivity growth

	1990Q1-98Q4	1999Q1-04Q3	1990Q1-04Q3
Economy wide labour productivity	1.1	1.2	1.1
Retail sector labour productivity	-0.4	1.0	0.1
Retail sector labour productivity (ex-accomodation)	0.3	1.3	0.7

Figure 12

Labour productivity growth in the retail sector (annual percentage change)



and this may limit the scope for productivity gains.[10] However, this explanation can be challenged: there has been a significant influx of new technology into the retail sector, such as electronic inventory management and sales systems. This, along with increases in the average size of retail stores, and highly competitive conditions, may have been expected to result in substantial productivity gains.

As shown in figure 12, growth in retail sector productivity tends to move in line with productivity in the wider economy. The large fall in productivity in the retail sector in 1997 was driven by a substantial fall in retail sector activity over this period. This may have been a result of the decline in tourist numbers following the 1997 Asian Crisis, which had a significant impact on parts of the retail sector (including accommodation and stores catering for tourists).

In light of the trend towards more international retailers in New Zealand, it is interesting to compare productivity growth with that seen overseas. Insights into retail sector productivity in New Zealand compared to the OECD are illustrated in a recent paper by the OECD on the services economy.[11] The OECD combines the wholesale and retail sectors of the economy when reporting results. For 1980–1990 New Zealand had the lowest wholesale and retail sector labour productivity of the reported countries, at -1.0 per cent.[12] From 1990–2001 this increases to a level of 1.6, a level that was about average for the OECD.

6 Profitability

Given the substantial growth in sales over recent years, the increase in the number of operators within the sector and signs of relatively modest productivity growth, how has retail sector profitability fared? Unfortunately, the Statistics New Zealand Retail Trade Survey does not directly measure retail sector profitability, but an estimate can be gleaned from other sources.

In what follows, a measure of profitability is derived by subtracting purchases and labour costs from sales. This measure of profitability is analogous to an EBITDA (earnings before interest, tax, depreciation, and amortisation measure) and is calculated using the Regional Economic Indicator (REI) and Quarterly Employment Survey (QES) data. Estimates of total sales and purchases are obtained from the REI where they are derived from Goods and Services Tax (GST) data; the QES provides estimates for total labour costs.[13] An estimate of profit margins can be calculated by dividing the estimate of total profit by total sales.

In the retail sector, profit has increased significantly since 1999 (see figure 13). The rise in profitability is reflective of the strength within the sector over the period, and is also

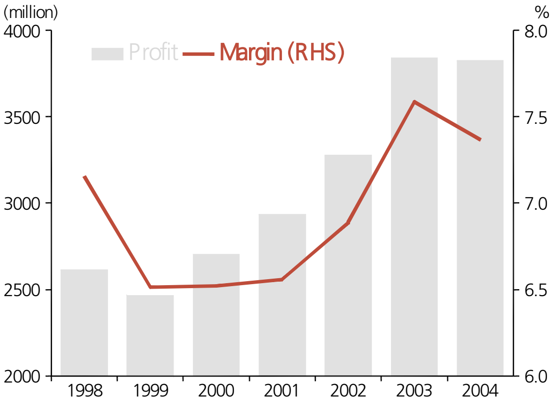
11 Ibid.

12 This does not include Hotels and Restaurants. If we include these operators, labour productivity growth is -1.4 per cent from 1980-1990, still the lowest value reported. This increases to 1.1 per cent in 1990-2001.

13 See Goh, Khoon "Overview of the New Zealand corporate sector" Reserve Bank *Bulletin*, Vol. 68, No. 2, June 2005, for estimates of profitability in other sectors.

Figure 13

Profitability in the retail sector.



a reflection of the recovery from the lower levels of profit following the 1997 Asian crisis. While growth in profits has been strong, this has levelled off over the last year. The data suggest only a small increase in profit margins, from a level of 7.2 per cent of sales in 1998 to 7.4 per cent of sales in 2004. This small increase in profit margins may reflect the relatively competitive nature of the retail industry and the increase in the sector's size that was noted earlier. In contrast, profit margins in the accommodation, cafes and restaurants sector appear to have increased substantially since 1998, from 9.7 per cent to 15.5 per cent in 2004 (figure 14). Actual profits have also increased significantly, albeit from a very low level in 1998. The rise in profits has been largely driven by an increase in sales, with increased demand from international and domestic tourists.

To get an idea of how some New Zealand retailers have been performing, it is worth looking at the experiences of some of the major retailers listed on the New Zealand Stock Exchange.[14] Individual company reports have been mixed, with some stores reporting high levels of growth, while others have faced more challenging conditions. Annual sales are shown in figure 15. Note that the sales data for The Warehouse Group, Michael Hill International, Hallensteins Glassons Holdings, and Restaurant Brands New Zealand

Figure 14

Profitability for accommodation, cafes and restaurants.

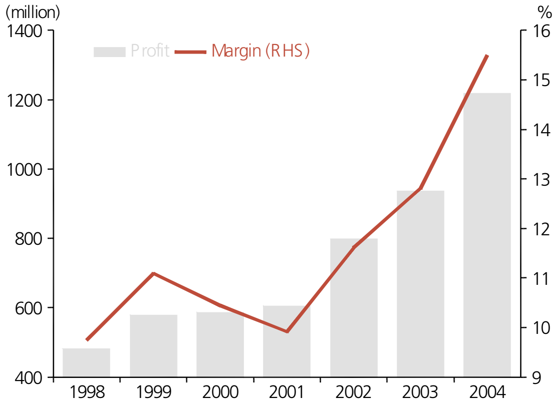
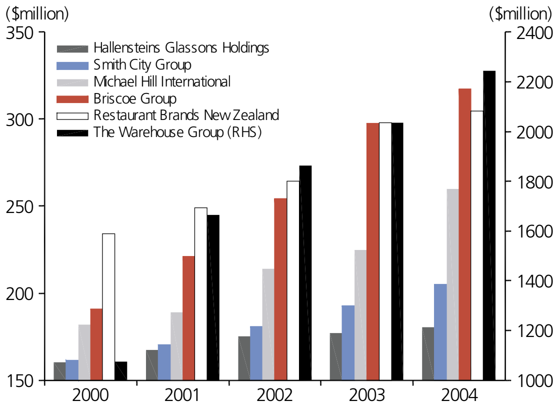


Figure 15

Annual sales of some major New Zealand retailers.

($NZ, thousands)



include sales from international branches; however, these sales tend to comprise a small proportion of total sales. Overall sales have been increasing steadily over time for these major retailers. Akin to profitability measures, growth in sales was strongest over 2001–2002 but has tapered off more recently.

While recent reports suggest performance is still mixed, overall the outlook for revenue seems a little more reserved. Stores associated with the housing market still note a boost to revenue as a result of high sales. However, in general, a fall in purchasing costs, fuelled by the high New Zealand dollar and low world prices of consumer goods, is thought not to have provided a major boost to earnings. This is reported to be the result of either an increase in operating costs due to the opening of new stores; or as a result of high competition

[14] We look at: The Warehouse Group Company Report for 2005 (Interim) and 2004 (Annual); Briscoe Group Ltd Annual Report ended 31st January 2005 and 2004; Hallensteins Glassons Holdings Annual Report 2004; Michael Hill International Annual Report 2004; Smith City Group Annual Report ended 30th April 2004; Restaurant Brands 2004 Report; Michael Hill International Annual Report 2004; Smith City Group Annual Report ended 30th April 2004.

leading to increased sales without increases in volumes (and with the increased costs associated with higher turnover). As a result some companies have reported decreases in sales on a square meter or same store basis.

7 Concluding comments

This article has provided an overview of the general trends within the retail sector over the past five years. Strong growth in retail sector sales, across all store types, is the most significant feature identified. Increased population, as a result of record levels of migration, a buoyant housing market, and high income levels, have underpinned high sales growth since 1999. At the same time, the overall size of the retail sector has also been increasing, with a tendency towards larger stores and retail chains. This reflects an international trend, with increased buying power, scale economies, and consumer preferences driving the trend.

The retail sector has shown lower rates of inflation than many other sectors. The very low or negative rates of inflation have been predominantly in those stores selling imported goods, or substitutes for imports; the ongoing fall in import prices driving lower prices in this sector. In addition, increased buying power as a result of increases in store size, and greater competition resulting from a larger international influence, adds to this effect.

While labour productivity in the retail sector appears to have increased over time, productivity growth rates have still been lower than for other sectors of the economy. This may be the result of increased capacity acting to suppress productivity, despite the high level of sales growth since 1999. Similarly, profit margins within the retail sector (ex-accommodation, cafes and restaurants) have remained relatively stable. Scale economies within the sector and the significant influx of new technology may lead to increased productivity in the future. Whether this increased productivity will transform into higher profit margins remains to be seen, however, in light of strong competition within the sector, and the more subdued outlook for sales recently noted by some retailers.