Submission to Inquiry into the Trade Practices Amendment (Guaranteed Lowest Prices - Blacktown Amendment) Bill 2009

By

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In this short submission, I begin by considering some potential problems with making the proposed legislation work. I then move on to considering whether the problem it seems aimed at addressing is really as serious as it seems at first sight.

If the proposed amendment is passed, its impact will to some degree be affected by the way in which retailing is organized. In some sectors that are dominated by big-brand retailers many retail outlets are actually franchise operations rather than branches of the firm whose brand the public sees. This is common is petrol retailing and electrical appliance retailing. In such cases, the franchisees are the initial purchasers of products that they on-sell to consumers. If the amendment has the effect of forcing the franchisers to provide their franchisees with stock at identical prices if the franchisers' depots are closer than 35km, its effects may be rather limited.

For one thing, the retail brand owners may have a very limited set of supply sources (e.g. petrol storage facilities, or offices that negotiate bulk purchases deals with suppliers on behalf of their franchises), so nothing much may change as far as the ability of the franchisers to control the input costs of their franchisees is concerned. Businesses that were not organized according to franchises but as multi-branch operations might be able to evade the intention of the legislation, if it did not apply to prices charged by franchised outlets, by reorganizing themselves as franchise systems at the retail level.

Secondly, if the legislation were to require uniform prices even from franchised outlets that are closer than 35km to each other, it could prove problematic to enforce if there is ambiguity regarding the meaning of 'price'. Most retail outlets supply multiple products and they often offer special deals to customers who purchase goods as bundles. If different bundling deals are offered at different sites or different sites offer different sets of products, there may still be plenty of scope for price discrimination. A particular brand of petrol might have the same price per litre across filling stations in a major city and well into its hinterland but unless the legislation is very cunningly designed consumers could still end up facing quite different deals if they bought petrol bundled with other goods, due to different outlets stocking different goods and having different bundling opportunities. This could make it very difficult to police: for example, how are regulators supposed to deal with some products being spectacularly cheap across a geographical area at all outlets but readily available at some and supposedly suffering from 'stock out' problems at other outlets?

The point in the previous paragraph can be put more generally: if legislation is able to impose uniform pricing across a geographical area in which major players wish to offer strategically different deals at different locations, the major players will substitute non-price differences in what they offer as means of discriminating amongst their customers geographically.

If the only non-price aspect of competition were location, major players might argue that the proposed amendment gives undue competitive advantage to independent operators who seek to compete with major brands. By slightly undercutting their local rivals who supplied closely substitutable products, they would be able to steal much of the market share of the latter. To stop this, the major player would have to cut its prices at *all* of its branches within the zone of outlets within 35km of each other. The cost to the major of matching the lower price could thus be considerable. However, such an opportunity for competitive leverage would seem to be in the public interest so long as the independent were not cutting prices below levels that would be sustainable for it in the long run if the major player chose to lower its prices across the entire area to protect the market share of a particular one of its outlets.

Where the major players might have a more justifiable case for squealing would be in cases where an independent every now and then started a price war on one of their local branch outlets by charging a price that was so low that it was only profitable for the independent via the bigger market share that it would enjoy so long as the major delayed engaging in expensive retaliation that would see the prices of all players fall below what would be sustainable in the long run. It should be recognized, however, that much the same situation exists in cases where retailing is based around price competition even if the major players are not banned from geographical price discrimination. Suppose, for example, there is an independent petrol retailer at Bridgewater at the end of Hobart's Northern Outlet highway. If it cuts its prices unilaterally, it will have a major impact on the sales of the next filling station along the road and if that one responds (perhaps aided by support from a major oil company), the next one along will face a loss of market share. Very soon, there is a chain reaction all the way down the road to central Hobart. In the short run, the maverick independent makes a temporarily higher profit due to its temporary increase in market share but very soon this is turned into losses as its market share shrinks back to its former level. Such a competitive structure is likely to result in ongoing price volatility around an average price that generates normal profits. The customer over the long term incurs the costs of having to be more alert than in a case of stable pricing and may gain nothing in return.

The logic of competitive chain reactions of the kind outlined suggests that a major player may sometimes find it very expensive to engage in predatory pricing to 'nip in the bud' competition from a new individual operator. To cut prices at a major's outlet near to the new independent may result in the independent following suit and putting pressure on other of the major's branches, and so on. Indeed, if the various outlets are spread out across an area rather than along a major road, it may be impossible for the major to cut the prices at one of its branches without causing problems for other of its branches just as quickly as it does so for the independent that is the target of its actions. While the major player may have 'deep pockets' to dig into to invest in wiping out an interloper, it may make little sense to do so if the interloper is not trying to get a slice of the market by aggressive price competition and already imposing costs on the major's branches in surrounding suburbs. This being so, the best strategy for an interloper is to locate in an area with many surrounding suburbs such that it can seek to build up a clientele by means of non-price competition (good service, range of stock, and so on) and take a *limited number* of customers from *each* of many of the established firm's (or firms') outlets.

Once we recognize that spatially-based competition is not a case merely involving an independent being challenged by a single local rival capable of being supported by its head office, the case for the proposed amendment thus looks rather smaller. It becomes smaller still to the extent that a major operator finds it advantageous to use region-based promotion strategies (e.g. junk mail catalogues or local TV advertisements) that apply to all of the branches it operates within the area.

Finally, it needs to be said that new entrants are often well-established players diversifying into new territory, rather than 'mom and pop' kinds of small businesses. These entrants often have 'deep pockets', too, and may compete by different kinds of strategies, as with the case of Aldi's entry into the grocery sector. For such entrants the big issue often will not be fear of the incumbents trying to nip their new operations in the bud by a local price war but rather the problem of getting access to suitable sites from which to compete, either because of planning and environmental rules getting in their way, or because of prime shopping mall sites being taken by incumbents. It is in the latter kinds of areas that changes in policy might have a bigger impact the value for money enjoyed by consumers.