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HOUSE OF REPRESENTATIVES STANDING  
COMMITTEE ON INFRASTRUCTURE AND  
COMMUNICATIONS

Committee Inquiry into IT Hardware and  
Software products

**AIIA Response**

6 July 2012

## INTRODUCTION

The Australian Information Industry Association (AIIA) is the peak national body representing suppliers and providers of a wide range of information technology and communications (ICT) products and services. Its membership comprises approximately 400 of the top international corporations as well as small to medium enterprises currently supplying innovative applications in all economic sectors in Australia. AIIA's National Board of Directors includes major multinational corporations doing business in Australia (see Appendix I).

AIIA welcomes this opportunity to respond to the current inquiry into IT Hardware and Software Product Pricing, requested by Minister Conroy on 18 May and specifying the following Terms of Reference:

***(a) Whether a difference in prices exists between IT hardware and software products, including computer games and consoles, e-books and music and videos sold in Australia over the internet or in retail outlets as compared to markets in the US, UK and economies in the Asia-Pacific***

***(b) Establish what those differences are***

***(c) Determine why those differences exist***

***(d) Establish what the impacts of these differences might be on Australian businesses, governments and households***

***(e) Determine what actions might be taken to help address any differences that operate to the disadvantage to Australian consumers***

In calling for this inquiry, Minister Conroy wrote to the Chair of the House Standing Committee making supporting reference to the 2011 Productivity Commission Report into the Australian retail Industry. In that Report, the Commission noted that it was:

*aware of the longstanding practice by which some international suppliers set differential regional prices. This effectively treats consumers in one region as willing, or able, to tolerate significantly higher prices than those in other regions. Australian consumers have an increasing awareness of such price differences and are now able, in many cases, to circumvent them by directly ordering online. This represents an example of 'parallel importing' which is the import of genuine products without the permission of the local licensee. Some international suppliers have attempted to defend price discrimination due to the cost of supplying a remote and relatively small market like Australia, which in some cases has its own unique requirements. These arguments in most cases are not persuasive, especially in the case, for example, of downloaded music, software and videos where the costs of delivery to the customer are practically zero and uniform around the world. Addressing such regional price discrimination is one of the main challenges for local retailers. If retailers cannot purchase the goods that they resell at competitive prices, more business exits and loss of employment will occur. The threat of parallel imports may help motivate*

*international suppliers to change their regional pricing policies. It would seem likely that many international suppliers will want to retain local agents and retailers to support and service their products in the Australian market.”<sup>1</sup>*

AllIA notes that this statement by the Productivity Commission raises several issues concerning product support costs, international supply-chain costs, and the differences between the bricks and mortar (“b&m”) retail market and the online market. The Commission’s Report **did not** review differentials in pricing between global regions; its concern was the impact of online trading on Australia’s 140,000 B&M retailers, and consequent ‘parallel importing’. It’s focus was not specifically on the ICT industry. At the outset it needs to be understood that the differential in pricing is an economy-wide trait in Australia and is not limited to the ICT sector. Across the board many products and services are more expensive in Australia than in (say) the US market. Retail is not an amalgamated sector; sports’ goods, apparel, and manchester are examples of purchases which are far cheaper in other markets, most notably the US. Any traveler to the US, even before the parity of the dollar, will have seen the range and breadth of retail choices in that market at much lower prices.

Costs associated with product and service sales in this market such as GST, customs duty and regulatory requirements such as consumer guarantees under the Australian Consumer Law (ACL) which impose strict warranty requirements on suppliers and which, vendors advise add cost to their business, all contribute to Australian based product pricing. The alternative – which is for suppliers to only do business in more favorable markets, ultimately leaves the Australian economy and Australian consumers worse off.

More generally the cost of doing business in Australia are higher than in many other countries including more costly retail lease rents and a more costly labour market with high wages.

Some vendors have calculated that business costs in Australia are between 5-10% higher than any other in which they do business and these costs are passed on to consumers. Conversely, others report that the recent failure of some overseas markets has resulted in the reduction in the price in some products in comparison to prices two-three years ago.

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<sup>1</sup> Australian Retail Industry. Productivity Commission report, December 2012, page XXIII

<sup>2</sup> Baker, Michael. 2009. US and Australian Shopping Centre Performance Comparison. P 11

ICT companies, like other business also have a variety of business models resulting different pricing strategies (e.g. bundling, advertising based models versus intellectual property based models). Some members have brought to our attention the fact that they do not set the retail price of their products. These are set through their partner channel and hence are also influenced by channel specific market factors and cost pressures.

In any case and as also noted by the Productivity Commission, snapshot comparisons are not useful ways of comparing prices: in Australia GST is included in retail prices whereas in the US Sales Tax is paid at the register.

At a more general level – and across a range of markets - the practice of price differentiation is a common business strategy necessary to maximise performance in a specific high-cost market such as Australia.

Overall Australia is a very small player in the global retail landscape (less than 2%). In this respect Australia is not able to leverage the same economies of scale enjoyed by other markets, such as the US.

## **Response to Terms of Reference**

In terms of pricing across Australia's ICT sector AIIA's response to each of the issues raised in the Inquiry are set out below. For ease we have grouped our response to requirements (a), (b) and (c) together. You will see we have also given consideration to IT hardware, software and professional services pricing separately.

***(a) Whether a difference in prices exists between IT hardware and software products, including computer games and consoles, e-books and music and videos sold in Australia over the internet or in retail outlets as compared to markets in the US, UK and economies in the Asia-Pacific***

***(b) Establish what those differences are***

***(c) Determine why those differences exist***

## Hardware

Global IT hardware price variances are the result of multiple factors including local costs of doing business, retail support requirements, distribution chains and statutory and regulatory imposts.

Vendors have specifically identified:

- Federal and State based tax and statutory requirements requirements such as GST (+10%), payroll tax, superannuation, workers compensation requirements, penalty rates, tariffs;
- Regulatory requirements related to supporting and managing consumer guarantees required under the Australian Consumer Law. While not quantified vendors advised that the service infrastructure to support these arrangements, though possibly only incremental, are ultimately also reflected in retail costs;
- Business operating costs specifically higher Australian property/rental costs and wage costs
  - A report by retail specialist Michael Baker calculated that in 2009, occupancy costs in digital product retail were, on average 9.6% in the US and 12.8 % in Australia<sup>2</sup>;
  - Compared to other countries, wages in Australia have risen dramatically in recent years. There are two reasons for this: actual wages have risen; and the value of the Australian dollar has risen compared with other currencies. As a result Australian wages are relatively high compared with workers in comparable markets. The average full-time wage in Australia at the end of 2010 was \$66,594 a year. Converting this to other currencies the 2010 exchange rate gives an average wage in Australia of US\$68,370, £42,580 or €48,500. In comparison, the average full-time average wage in these countries/regions was: USA: US\$44,980; UK: £25,355; Germany: €42,535.<sup>3</sup>

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<sup>2</sup> Baker, Michael. 2009. US and Australian Shopping Centre Performance Comparison. P 11

<sup>3</sup> <http://www.jobsabroadplus.com/very-high-wages-in-australia/>

- More recent data comparing the US and Australia shows Australians are paid quite a bit more. The federal minimum wage in the US is US\$7.25 per hour (although this may vary from state to state). In Australia, the minimum wage for a junior employee over the age of 20 is AU\$15.59 per hour, some 121% higher<sup>4</sup>. In February 2012 the average full-time weekly wage in Australia was AU\$1047.20, compared to the average weekly American earnings in the US for the same period, of US\$807.22, some 25% less<sup>5</sup>.
- Vendors have also identified training and marketing costs, again directly related to the cost of staff;
- Supply chain and reseller costs: margins applied at each point of the chain and in the case of a number of our vendors, dictated by reseller partners;
- Importation costs due to the distance from manufacturing countries, compared to that of the US, combined with our much smaller population, shipping goods to Australia is more costly and hence reflected in retail prices; and
- Distribution costs, particularly in terms of import tariffs and coverage across a low density geography.

When combined these factors impact the overall cost of production, distribution and service and are ultimately reflected in retail prices.

### *Software*

Consideration of software pricing issues covers two scenarios:

- (i) where software is supported by a distribution model (including where software is purchased at a retail outlet or online); and

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<sup>4</sup> <http://www.cnet.com.au/australian-price-gouging-is-it-what-we-think-it-is-339340654.htm>

<sup>5</sup> <http://www.cnet.com.au/australian-price-gouging-is-it-what-we-think-it-is-339340654.htm>

(ii) where software is available and downloaded online.

In the instance of (i) above it is acknowledged that there is some incremental price difference between the prices of some digital media software products within the US as compared to Australia. This is attributed to two key issues: market conditions and distribution costs.

Vendors advise that the cost of doing business in the Australian market is higher per unit of revenue earned than in the US. In a large homogenous market like North America suppliers are able to achieve economies of scale that affect pricing primarily by leveraging two significant channels: volume channels supported by a vast network of resellers and the retail/etail channel. In the US these channels create significant efficiencies in the distribution and/or sale of digital media products.

In Australia, by contrast, the costs associated in maintaining distribution channels are materially higher: for example, the cost impact on distributors and retailers supplying a large, low density geography such as Australia's.

Additionally, the differential in prices between the US and Australia are engendered by different cost structures such as the imposition of GST to product pricing, customs duties, consumer guarantees and differences in the parities of currencies between the US and Australian dollar. Suppliers also have higher corporate infrastructure and employment costs (Australia is recognized as a high labour cost market as outlined above) in maintaining point of presence and pre and post sales services and support, marketing, training and business development operation in Australia.

In terms of downloadable software ((ii) above) it is important to understand that whilst transportation, distribution and manufacturing costs may be reduced, other costs such as advertising, marketing, administration and support still apply and will be based on that specific countries cost of doing business. The price of downloads will still reflect the margins required to ensure the locally based arm of the business is able to maintain its presence in that country. In these instances the locally based presence is subject to the same labour and business operating costs (infrastructure, business development, training, marketing etc.), as other businesses operating in the same market (i.e. Australia). While on the one hand this has implications for local market pricing, on the other it is about maintaining a local presence, which at the macro level has broader economic implications in terms of Australian employment and productivity indicators. Even

contemplating a world where most products are sold online or downloaded, to the extent that specific localities want to attract and/or retain a physical presence of businesses that would otherwise not operate in that area/region, the cost of the product in that area/region is likely to impact the cost to retain the local operation.

### *IT Professional Services*

In the area of ICT professional services Australia is largely comparable to equivalent economies. Where differences do exist these are largely driven by cost of living, skills shortages and infrastructure related issues. Currently salaries are being driven by a mixture of the cost of living in major Australian cities and also a shortage of appropriate ICT skills in the market. In other words, many of the same cost pressures that impact software and hardware costs.

The skills issue in particular, is impacting both demand for ICT skills and the way in which this is addressed by some of the larger ICT professional services and system integration companies. Where skills cannot be sourced within Australia, they are being recruited/seconded from overseas. Where these are sourced from lower cost labour markets (such as India or China), the cost of resources is globally comparable - including when the work is either off-shored or on-shored. In instances where specific, unique global expertise is brought to Australia the cost of these resources is typically more expensive. This is attributed to either the rarity of that knowledge or the specific nature of the expertise required. Generally these costs are confined to a specific project.

The issue of skills and the flow on short and long-term impacts for Australia is one that has already been raised by the AIIA with Government. In student numbers alone, the last decade has seen a dramatic reduction in the number of ICT students with only marginal improvement in numbers (less than 1%) over the last 2 to 3 years.

In terms of infrastructure related cost impacts, the global trend is towards a larger number of smaller projects, each of which can be more tightly controlled – a trend that is still in its infancy in Australia. One of the drivers for this global trend is the move towards rapid deployment using “cloud” technology. To date this is not an approach that is being leveraged in Australia mainly because many of the major providers don’t yet offer Australian-based hosting which therefore



limits their deployment or adds an extra layer of services to take advantage of the technology. There is a risk of course, that this model will not be adopted in Australia in any case given that uptake of cloud overall has been slow and the potential reluctance to establish a data centre presence in Australia due to cost and lack of scale.

Bearing in mind all of the above, while we appreciate the concerns of Internet savvy consumers and acknowledge that prices for some IT products in Australia may be incrementally more expensive than some overseas markets, it needs to be emphasised that there is much less of an appreciation of Australia's higher operating cost environment.

***(d) Establish what the impacts of these differences might be on Australian businesses, governments and households***

Where the impact of market conditions, infrastructure and operational costs impact the price of, in particular IT hardware and software costs, a pricing differential between Australian and overseas markets will occur and naturally this impacts the purchase price for all parties – consumers, businesses and government. However, insofar as Australia is itself an open, competitive market, pricing is equally subject to and constrained by, comparative local competition.

***(e) Determine what actions might be taken to help address any differences that operate to the disadvantage to Australian consumers***

At a macro level the Australian market now faces a truly globalised trading environment to which it will need to adjust. Vendors acknowledge that this will impact their business models and that market players will have a shared responsibility to balance in terms of the desire and costs that go with servicing a local market and the increasing pressure of global markets. This includes: manufacturers who produce products/goods that are increasingly open to competitive overseas production markets; governments that oversee tax and regulatory requirements who need to ensure these are not overly burdensome and costly compared to Australia's competitors in the same markets; retailers who will need to ensure that their cost of business is competitive with overseas benchmarks (as far as possible bearing in mind local cost pressures); and consumers who

need to understand the value of buying locally, e.g. in terms of before and after sales service and support.

We have been advised by some vendors that they are sensitive to consumer pricing concerns. In some instances this has resulted in them changing their go-to-market strategies, including offering cloud and product subscription offerings aimed to achieve greater price parity between US and Australian prices. It should be noted in this context that the Government policy position on cloud will potentially have a significant impact, i.e. if policy settings mean companies are limited in what cloud services they can offer (i.e. a requirement to host data onshore) then there is a real risk that businesses will miss out on the benefits of cloud, i.e. improved cost efficiency and effectiveness.

## APPENDIX 1

### AIIA Board of Directors

#### **Chairman**

Philip Cronin  
*General Manager*  
*Intel Australia & New Zealand*

#### **Deputy Chairman**

Kee Wong  
*Managing Director*  
*e-Centric Innovations*

#### **Treasurer**

Russell Yardley  
*Director*  
*Algonquin Investments*

#### **Immediate Past Chair**

John Grant  
*Managing Director*  
*Data #3*

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Warren Anderson  
*Group Vice President*  
*Asia Pacific Gartner Australia*

#### **Adele Beachley**

*Beachfront Consulting*

#### **Ian Birks**

*CEO and Managing Director*  
SKRIB

#### **Bob Hayward**

*Director*  
*CSC Australia*

#### **Jackie Korhonen**

*Chief Executive Officer and Managing Director*  
*Infosys ANZ*

#### **Pip Marlow**

*Managing Director*  
*Microsoft Australia*

#### **Nick Leeder**

*Managing Director*  
*Google Australia*

#### **Suzanne Roche Director**

*Smartnet Pty Ltd*

#### **Andrew Stevens**

*CEO & Managing Director*  
*IBM Australia & New Zealand*

#### **Tom Stianos**

*Chief Executive Officer*  
*SMS Management & Technology*

#### **Jeyanand Jeevaratnam**

*Managing Director*  
*Avanade*

#### **David Webster**

*President, ANZ*  
*EMC*