

Explanations for IT price differences

- 3.1 In chapter 2, the Committee concluded that Australian consumers and businesses do pay higher prices for many IT products when compared to comparable products sold in the United States. The terms of reference for this inquiry ask the Committee to investigate possible reasons for these price differences.
- 3.2 The Committee has never entertained the notion of a single explanation for higher IT prices. The Committee has sought to examine the reasons given by business, consumers and other observers for the higher prices paid by Australian consumers for IT products and services.
- 3.3 It is clear that a range of factors are involved and that these vary in effect from product to product. However, the Committee does consider it possible to draw conclusions about the validity and relative importance of the main explanations for the pattern of IT pricing in Australia.
- 3.4 Industry groups and the majority of IT companies have argued that higher prices are caused by a range of factors which vary significantly depending on the market and the product and services in question. In addition to arguing that price comparisons are an unreliable measure of the value they provide to consumers, industry groups have argued that price differentials for a number of IT products are narrowing.
- 3.5 Mr Russell Zimmerman, Executive Director of the Australian Retail Association (ARA) noted that there was evidence of 'a substantial deflation in electronics and of software price reductions', much of which could be attributed to changes in the value of the Australian dollar. Mr Zimmerman nonetheless noted that:
 - ... there are still clear disparities on many products and services. The real question is what do we believe is causing these? We

believe some of the reasons for this are tariff application and parallel importing, regulation, wages and supply chain.¹

- 3.6 The Australian Information Industry Association (AIIA) attributes high prices to general factors such as ‘local costs of doing business, retail support requirements, distribution chains and statutory and regulatory imposts’, as well as shipping costs, ‘training and marketing costs, again directly related to the cost of staff ... [and] distribution costs, particularly in terms of import tariffs and coverage across a low density geography’.² Ms Suzanne Campbell, CEO of the AIIA, argued that prices for a range of IT products were falling:

The *Canon Consumer Digital Lifestyle Index – 2nd Half 2011* reports that the average selling price for digital devices at Australian retail stores continued to fall, dropping 13½ per cent across all reported categories. This price decline sharply contrasts with overall inflation of 3.1 per cent.³

The Committee notes that Ms Campbell’s claim does not address whether prices for these products were falling relative to prices in the US, just that they were falling.

- 3.7 Initially, this chapter considers some general issues relating to price discrimination, including who sets prices of IT products. The Committee notes that there is no single agreed position among industry bodies. Several general reasons proposed by industry are then explored, namely claims about:

- differences in advertised prices
- relative market size
- wages and occupancy costs
- warranties and green schemes
- exchange rates
- channel partners, and
- localisation costs.

- 3.8 The chapter then considers some responses from representatives of major industry sectors and vendors to claims made by consumers, especially with regard to digitally delivered content. The chapter then concludes by surveying a range of industry views about how business operates in the current IT environment.

1 Russell Zimmerman, *Committee Hansard*, Sydney, 30 July 2012, p. 27.

2 Australian Information Industry Association, *Submission 73*, pp. 5-6.

3 Suzanne Campbell, *Committee Hansard*, Sydney, 30 July 2012, p. 1.

Responsibility for international price discrimination

3.9 The Committee heard a range of evidence in relation to who sets prices for IT products, although few substantive submissions on this issue were received from individual IT retailers, nor did the ARA directly address the issue. While not seeking to revisit the comprehensive 2011 report of the Productivity Commission into the Retail Industry, the Committee notes that price discrimination can occur at various levels, against retailers at the distribution level:

Specifically, this discrimination is in the form of brand owners or international suppliers/manufacturers charging higher prices to Australian retailers relative to the prices they charge to similar retailers in other regions. These comparatively higher international supplier prices are then passed on to consumers.⁴

3.10 The Committee also notes the observation in the Productivity Commission report that:

It is clear that international price discrimination is being practised against some Australian retailers, to the detriment of Australian consumers.⁵

Addressing perceptions of price discrimination

3.11 As noted earlier, the Committee is aware of many areas where industry explanations for significant price differences generally relate to the cost of doing business in Australia. These are described below, before a more detailed discussion of matters relating to digitally delivered content.

Advertised prices

3.12 The Committee acknowledges that some confusion about pricing exists because of different rules in various jurisdictions about including tax in advertised prices. In Australia, advertised prices must include GST, while in the United States advertised prices do not include sales taxes, which may differ across state jurisdictions. Mr Tony King, Vice President of Apple Australia, advised that:

4 Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, p. 156.

5 Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, p. 163.

When comparing prices it is important to remember that the US retail prices do not include sales tax. Here in Australia, of course, a price includes a 10 per cent GST. That fact alone is responsible for a great deal of confusion and has resulted in some inaccurate conclusions regarding our pricing.⁶

Market size

- 3.13 In broad terms, industry groups and IT companies argue that Australia's economy is smaller than many comparable markets and that Australia is therefore a higher-cost environment in which to do business.

Mr Zimmerman observed that:

Australia is really a very small player in the global retail landscape, less than two per cent. In this respect, Australia is not able to leverage the same economies of scale as is often enjoyed by other markets such as the US or UK.⁷

- 3.14 The Department of Broadband, Communications and the Digital Economy (DBCDE) acknowledged that while Australian consumers are heavy users of technology, the small size of the Australian market may contribute to higher prices than in larger markets overseas:

In comparison with other regions, Australia is not a major market for software and hardware. With a relatively small population, it cannot support the level of competition found, for example, in the US, which has about 14 times the population and about 15 times Australia's GDP.⁸

- 3.15 Microsoft noted that, while it only provides 'guidance' on recommended retail pricing to its channel partners, its guidance:

...is impacted by market forces including but not limited to the size of the market, which affects supply and demand...⁹

Wages and occupancy costs

- 3.16 Industry submissions argued that wage and occupancy costs contribute to higher overall costs faced by companies selling IT products in Australia, especially products distributed through retail distribution channels.
- 3.17 The AIIA submission pointed to higher wages as a driver of higher costs in Australia. The AIIA argued that wages have 'risen dramatically' in

6 Tony King, *Committee Hansard*, Canberra, 22 March 2013, p. 1.

7 *Committee Hansard*, Sydney, 30 July 2012, p. 27.

8 Department of Broadband, Communications and the Digital Economy (DBCDE), *Submission 55*, p. 4.

9 Microsoft, *Submission 67*, p. 3.

recent years – both in absolute terms and in terms of purchasing power, as the Australian dollar has risen against the US dollar:

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: €42,535.¹⁰

3.18 The Australian Home Entertainment Distributors Association also highlighted Australia's higher labour costs:

- Minimum hourly adult wage: (currency conversion as at 29 May 2012):
 - ⇒ UK is £6.08 = A\$9.682
 - ⇒ US is \$7.25 = A\$7.373
 - ⇒ Australia is \$16.514.¹¹

3.19 The Committee notes, however, that hourly and average wage figures are not an accurate indicator of total labour costs. In its 2011 Retail Industry Report, the Productivity Commission concluded that 'comparisons of minimum wages provide no real insight into relative retail industry labour costs in different countries'.¹² The Commission noted that a range of factors contribute to total labour costs in addition to wages, including, for example, paid leave and contributions to pension and insurance funds.

3.20 On that basis, the Commission conducted its own analysis of hourly labour costs in a number of European countries in addition to Australia and the US. It found that, when wages and benefits (including paid leave, employer contributions to pension and insurance funds and government social insurance) were taken into account, hourly labour costs (converted to constant Australian dollar equivalents and also to US dollar Purchasing Power Parity equivalents to adjust for relative purchasing power) were lower in Australia than in the US. When calculating labour costs as a proportion of retail sales, however, Australia was slightly more expensive than the UK and the US.¹³ The Commission therefore came to the conclusion that labour costs were indeed higher in Australia as a

10 Australian Information Industry Association, *Submission 73*, p. 5.

11 Australian Home Entertainment Distributors Association, *Submission 58*, p. 3.

12 Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, C.3-C.8.

13 Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, C.6-C.7.

proportion of revenue, even if they were comparable or lower in absolute terms.

- 3.21 Retail rents and occupancy costs were also cited as factors affecting the cost of doing business in Australia. The AIIA argued that rent costs, while ‘not usually directly related’ to AIIA members’ expenses, nonetheless affect IT pricing, because a significant proportion of their services are sold through channel partners. Ms Campbell said that rents ‘have a profound effect’ on channel partners:

... a very significant part of their operations is in both the retail outlet and more specifically and generally in wholesaling operations. These costs are real and they are understood to be contributing significantly to the increase in costs in Australia.¹⁴

- 3.22 Mr Zimmerman of the ARA argued that while there had been some recent reductions in retail occupancy costs, retailers were nonetheless forced to pay too much rent for business premises:

It is very well documented that rents in Australia are artificially set high against places like the US and Europe.¹⁵

- 3.23 The Productivity Commission highlighted research in its 2011 Retail Industry Report that indicated that:

... labour costs and rental expenses can be as high as 70 per cent of the Australian retail industry’s operating costs – high by global standards.¹⁶

Warranties

- 3.24 Several submissions to the inquiry made the claim that the warranty provisions of the Australian Consumer Law (ACL) contribute to high IT prices in Australia. Ms Campbell, of the AIIA, stated that warranty costs in Australia are as high as anywhere in the world, characterising the warranty scheme created by the ACL as:

... a very expensive scheme. The warranty provisions speak to the reasonable life of the product. That could be three years in the case of some of our members’ products. That makes the provision of warranty for those products very expensive in this market.¹⁷

- 3.25 Ms Campbell added that:
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14 *Committee Hansard*, Sydney, 30 July 2012, p. 4.

15 *Committee Hansard*, Sydney, 30 July 2012, p. 28.

16 Productivity Commission, *Economic Structure and Performance of the Australian Retail Industry*, 2011, p. 148.

17 *Committee Hansard*, Sydney, 30 July 2012, p. 6.

One of my members has reported that, from their experience, our consumer warranty environment is the most expensive that they are dealing with in the world.¹⁸

3.26 In its submission to the inquiry, DBCDE observed that:

Warranties in Australia can be more rigorous and provide greater protections than those in other countries. The Australian Consumer Law, a schedule of the *Competition and Consumer Act 2010*, can provide different and in some cases stronger protections than that found in US or UK law. Where goods are faulty, this may result in higher costs for importers than they might face if they operated in other markets.¹⁹

3.27 Ms Molly Lai of Pioneer Computers referred to warranty protection costs:

Strong consumer protection in Australia means high support costs for IT vendors. Consumers see it as their rights to return for refund or replacement even when it is not the manufacturers' fault. In light of the new Australian Consumer Law calling for compensation for consequential losses ... IT vendors are finding it very hard to do business in Australia.²⁰

'Green' schemes

3.28 DBCDE also pointed out that IT vendors may incur higher costs as a consequence of so-called 'green schemes' that are designed to encourage the recycling of used televisions and IT equipment:

Commonwealth, State and Territory and local government schemes to cover the costs of recycling IT goods can contribute to the costs of hardware products bought in Australia. For example, the National Television and Computer Recycling Scheme can contribute to the costs of providing goods to the Australian market, as it places responsibility on manufacturers and importers to partake in product stewardship arrangements at their own expense.²¹

3.29 The Australian Industry Group (Ai Group) also attributed higher local costs to environmental regulations, noting that higher costs were in part a result of:

18 *Committee Hansard*, Sydney, 30 July 2012, p. 4.

19 Department of Broadband, Communications and the Digital Economy, *Submission 55*, p. 9.

20 Molly Lai, *Submission 6*, p. 1.

21 Department of Broadband, Communications and the Digital Economy, *Submission 55*, p. 9.

... environmental regulation such as minimum energy efficiency requirements and the new National Television and Computer Recycling Scheme, which imposes significant costs on suppliers of equipment subject to the scheme.²²

- 3.30 Ms Molly Lai also noted that the National Television and Computer Recycling Scheme, 'making importers and manufacturers bear the burden of recycling' has an impact for IT vendors.²³

Exchange rates

- 3.31 Many consumers have expressed frustration that, in their view, IT product prices have not declined in response to the appreciation of the Australian dollar. In addition to submissions to this inquiry, the Committee is aware of substantial public comment in social media and on the internet where consumers consistently raise this issue.

- 3.32 The Committee has received evidence suggesting that prices may take some time to match changes in the exchange rate. As DBCDE noted in its submission there can be a number of reasons for this 'sticky' pricing (in which there is a delay between currency value changes and the consequent adjustment in prices):

These delays can reflect inefficiencies in the supply process or where some importers buy stock well ahead of time in order to protect against currency fluctuations. To some extent, these delays are fixed, for example where the discrepancy is caused by an overstock of goods purchased at an earlier, higher price, or where the price is fixed through a long-term contract. The stability may also reflect lower competition in the Australian market and/or strategies where vendors seek to add value to products rather than reduce prices.²⁴

- 3.33 Ai Group noted that a number of factors can affect exchange rate pass-through:

- Supply contracts may be in place that have fixed exchange rates built into them.
 - The lag time between the placement of orders for imported products and the sale of the product in Australia can encompass a number of fluctuations in the spot price.
 - Many business costs are not affected by the exchange rate (for example, domestic labour, freight, transport, storage and regulatory costs).
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22 Australian Industry Group, *Submission 56*, p. 5.

23 Molly Lai, *Submission 6*, p. 1.

24 Department of Broadband, Communications and the Digital Economy, *Submission 55*, p. 6.

- As suppliers and retailers generally offer a large number of individual products it would be impractical to constantly reset these prices based on frequent movements in the spot price.
 - The desirability for consumers, suppliers and retailers of having relatively consistent pricing of goods, smoothing out fluctuations in the exchange rate.²⁵
- 3.34 Major IT vendors stated in submissions that their priority was to provide consistent, efficient and fair pricing rather than to respond to exchange rate fluctuations. For example, in its submission, Microsoft said that:
- Microsoft's global policy is to provide consistent and predictable local pricing while maintaining reasonable alignment of local currencies relative to the US dollar.²⁶
- 3.35 Adobe said that its policy was to set balanced prices:
- Both suppliers and customers would like to be able to enjoy the benefits of favourable currency movements and avoid the costs of unfavourable currency movements. However, fair and efficient pricing needs to strike a balance between upward and downward currency movements.
- Since most of our business is derived from the local ecosystem, Adobe has an AUD price list which ensures our distributors can always purchase from Adobe in AUD. This leaves the foreign exchange rate risk to be carried by Adobe.²⁷
- 3.36 Apple also emphasised consistency in pricing:
- Foreign currency is an important variable in how product prices are compared between countries. It is not uncommon for macroeconomic factors to cause foreign currencies to fluctuate dramatically during a product's life cycle. Over the period of time a particular Apple product is in the market, it may appear to be either priced higher or lower in a local market when compared to the price in the United States or elsewhere... The company's typical practice in such circumstances is to keep local prices the same, whether unfavorable [*sic*] or unfavorable to the company, until replacement products are introduced. This is less disruptive for local customers and local business channels than if Apple were to reprice products up and down on an unpredictable basis in response to all such fluctuations.²⁸

25 Australian Industry Group, *Submission 56*, p. 4.

26 Microsoft, *Submission 67*, p. 2.

27 Adobe, *Submission 81.1*, p. 2.

28 Apple, *Submission 62*, p. 1.

Channel partners

3.37 Industry groups argued that another factor in higher Australian IT prices was the margin set by channel partners. The term 'channel' refers to the various conduits through which goods or services are delivered from producers to consumers.

3.38 Microsoft, for example, does not sell directly to Australian consumers, but rather through various kinds of 'channel partner'. According to Microsoft Australia's Managing Director, Ms Pip Marlow:

We work on a model where we have a channel and that channel is a little differentiated... we talk about the volume reseller channel. They are our large-account resellers, value-added resellers. They sell our volume licensing, enterprise agreements, select agreements, open agreements. We would then have our OEM [original equipment manufacturer] partners. If you are using a Toshiba, we would license our software to Toshiba to preinstall into the product. You would acquire the product through that. [Finally], we have our retail areas. That would be something like Harvey Norman or JB Hi-Fi, through to a small, single-proprietary business who would sell what is known as retail product.²⁹

3.39 Channel partners, Ms Marlow continued, can deliver different value-added services to their customers:

... [D]ifferent areas of the channel will deliver different services to the customers as they consume that product. It might be, as I said, Toshiba and their channel adding desktop management support for your hardware. It might be a volume licensing reseller adding deployment services or software asset management services. It might be a retailer helping the consumer and being their trusted adviser as they make IT decisions, and they would deal with support and management of that. Through each channel you would see different types of value-added services that they would put on as they are sold to the customer.³⁰

3.40 Channel partners of major IT companies are, for the most part, based in Australia. Industry groups argued that the costs incurred in moving products through the channel are partly responsible for price differences. The Committee learned from the AIIA that:

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

29 *Committee Hansard*, Canberra, 22 March 2013, p. 33.

30 *Committee Hansard*, Canberra, 22 March 2013, p. 33.

partner channel and hence are also influenced by channel specific market factors and cost pressures.³¹

3.41 Adobe, itself a member of the AIIA, observed that:

It is important to understand that around 85 per cent, the vast majority of Adobe sales, flow through local channel partners. Adobe's local channel ecosystem is estimated to employ around 3,000 people in Australia.... Since we conduct most of our business through our 500-plus local channel partners, the majority of the costs of the ecosystem as a whole are incurred locally and in local currency.³²

3.42 Adobe Australia's Managing Director Mr Paul Robson further noted that the prices of digitally downloaded products sold directly by Adobe are 'aligned' with the prices of physical media distributed through the channel, so as to protect channel partners' business:

... in relation to the electronic version of that [product], there is an exact equivalent of a physical product of it that is sold by our partners in a channel format. So the pricing generally is aligned to make sure that the partners can continue to run and operate a business in this country. Where there is not a product that is an exact equivalent, and that is the case for the cloud based product, the pricing is in line with that seen in other markets.³³

3.43 Microsoft also attributed at least some of the higher prices for its product to locally-based channel partners:

Microsoft provides guidance on recommended retail pricing... Microsoft does not, however, set the final 'to-the-customer' price. The channel and value-added partners who deliver those products to customers ultimately determine retail pricing.³⁴

Localisation costs

3.44 DBCDE noted that IT companies may incur costs in tailoring their products for the Australian market. This can include adapting a product to suit local laws and regulations or to better meet Australian consumers' expectations:

Products which provide customised features based on unique national characteristics, such as local accountancy practices, a

31 Australian Information Industry Association, *Submission 73*, p. 4.

32 Adobe, *Submission 81.1*, p. 2.

33 *Committee Hansard*, Canberra, 22 March 2013, p. 29.

34 Microsoft, *Submission 67*, p. 3.

person's accent or even the voltage and plug requirements for electricity, will generally require additional research and/or development work to be sold in Australia.³⁵

- 3.45 The Ai Group further argued that higher costs may be incurred in complying with local regulations:

In addition to general business regulatory costs such as taxation and OHS, Australian governments at the State and Federal level regulate IT products to ensure that they are safe, reliable and minimise their environmental impact. These regulations and standards impact on price and may differ from other markets. The sector specific regulations that apply to Australian IT products can include electrical safety requirements [and] labelling requirements for radiocommunications and telecommunications equipment such as the A-Tick and C-Tick Marks.³⁶

- 3.46 However, in evidence before the Committee, Mr King downplayed the significance of localisation costs, at least in relation to Apple hardware sold in the Australian market:

The product cost may vary slightly market by market. For example, a computer coming to Australia has a slightly different plug to connect to our sockets, etcetera, compared to a product going to the United States. There may be elements like that that would vary on a product bill of material country by country, but they will be small variations. ... [T]he product costs would be broadly similar. There may or may not be some puts and takes but I think it will be broadly similar across markets.³⁷

- 3.47 Mr Robson placed particular emphasis on the importance of providing consumers and businesses with IT products tailored to local and individual needs:

One of the great drivers of the internet is the ability for organisations to provide a personal and relevant experience. It is an interesting dynamic. When you actually look at what customers are demanding, it is experiences that are personalised, bespoke. As one of our technology sets in our digital marketing business, we work with customers every day to sell them technology that provides them a personalised, bespoke experience. In a global marketplace the risk for organisations is to become less relevant, to lose the relevance of interaction with an existing customer. To

35 Department of Broadband, Communications and the Digital Economy, *Submission 55*, p. 7.

36 Australian Industry Group, *Submission 56*, p. 5.

37 *Committee Hansard*, Canberra, 22 March 2013, p. 10.

drive that relevancy organisations seek to provide a personalised and bespoke experience.³⁸

3.48 Specifically questioned on how Adobe localises its products for the Australian market, Mr Robson responded:

When we look at relevancy around personalisation, that is in relation to the redirection of customers when they access our website. When customers access the Adobe.com website they can choose to see whichever website they wish to see. We automatically try to get them to look at the Australian site, for a number of different reasons. There is local content. There is information in relation to local user groups and communities that use our technology that they can learn from and contribute to. There is information that is relevant to the local market in relation to Australian based pricing and other content and information. That content is a richer and more personalised experience for an Australian customer than they would get if they accessed a webpage that was in another language or for another country. ... with relation to relevance and personalisation, the personalisation was not of the product; it was the experience when online.³⁹

3.49 The following exchange subsequently took place between Mr Robson and the Committee:

Mr Husic: ... What is the local experience, then, that people are obtaining? What is the benefit of it?

Mr Robson: There is access to user groups, communities, information, local pricing, local offers et cetera.

Mr Stephen Jones: Chat sites and blog sites?

Mr Robson: Exactly, yes, user communities where –

Mr Stephen Jones: How much are you suggesting we should be paying for access to blog sites?

Mr Robson: No, I am talking about the personalised experience when a customer is online with adobe.com. We seek to provide a personalised environment where they can interact with other users of our technology. That is how we go to market. One of our key interactions with our customer base is to allow them to talk amongst themselves and to work with us and to provide input into future innovation.⁴⁰

38 *Committee Hansard*, Canberra, 22 March 2013, p. 15.

39 *Committee Hansard*, Canberra, 22 March 2013, p. 16.

40 *Committee Hansard*, Canberra, 22 March 2013, pp. 16-17.

- 3.50 The Committee notes the evidence from industry that localisation represents an additional layer of cost incurred by some international IT companies selling into Australia. However, the Committee is of the strong view that in many product categories, particularly in relation to digitally delivered content, localisation costs would be negligible at best and certainly not account for the types of price differentials presented in evidence to the Committee.

Responses by product category

- 3.51 As noted in chapter 2, evidence was received across a range of products including hardware, software and digital downloads including music, games and books. The Committee acknowledges there are challenges when assessing industry explanations for pricing, because some evidence in submissions and at hearings makes little distinction between hardware, and digital downloads; some evidence refers to an overall approach by business. To that end, responses on certain product categories are considered below, before an assessment of some broader business principles.

Hardware

- 3.52 Noting the above observation, that evidence received is often made across, or on behalf of, a business which sells both physical *and* downloadable products, the Committee acknowledges the claims by Microsoft and Apple on their hardware prices. Apple's Mr Tony King observed that prices for recently released Apple hardware and software products are now near parity with prices in the United States:

Setting aside the daily ups and downs of currency exchange rates, our Apple product prices here in Australia are not materially different from the Apple products sold in the United States. In fact, today the price for the new iPad with retina display and the iPad Mini are within one to five per cent of the prices in the US. The same is true of Apple's own software titles offered on the Mac App Store, including Final Cut Pro, Logic, iPhoto, iMovie and GarageBand. These products are all priced in Australia within one to three per cent of the prices in the United States.⁴¹

- 3.53 Ms Marlow, noting that variations in the price of Microsoft products should be expected since the company does not endeavour to set a single,
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41 *Committee Hansard*, Canberra, 22 March 2013, p. 1.

global price, observed that the Australian price for some recent Microsoft products has been much closer to the US price:

[Microsoft Office] Home and Premium costs \$119 here, including GST, and \$99 in the US without tax. Office 365 Small Business Premium costs \$13.50 a month here, \$15 a month in the US. Office Home and Business for small business costs \$299 here, including GST, and \$219 in the US.... Office Home and Student 2013, which is the current version of the software, is \$169.00 ERP here including GST and \$139.00 in the US. So our price includes GST and the US price is without that But ultimately we do not have a global price and the prices may be different in the US or other jurisdictions.⁴²

- 3.54 As noted earlier in this chapter, while the Committee accepts views that prices may be *generally* lower, it notes that in some cases, the relative or proportional differential may be unchanged. That is, while costs are becoming lower in Australia, they are becoming lower *everywhere*; Australians are still bearing a proportionally high cost burden.

Software and digital downloads

- 3.55 Much of the evidence from IT vendors on software made little or no distinction between physical and digitally downloaded products. Further to the above consideration of explanations for higher prices for Australian consumers, the Committee sought to better understand the distinctions made for products which are essentially identical.
- 3.56 As outlined in chapter 2, many consumers expressed concern at price disparities for digitally delivered content, including software, music, games and books. The Committee considers this to be an area of special interest as many of the justifications for higher prices made by industry groups are arguably less relevant to digitally downloaded products. Many products sold online, for example, would appear to incur significantly reduced wage costs, much lower occupancy costs, and undergo little or no localisation (none at all in the case of music, movies and many e-books). The Committee is therefore especially interested in why these products still cost Australians more.
- 3.57 The Committee has heard differing views on the pricing of these kinds of digitally delivered content. For the most part, consumers expressed frustration and disbelief at having to pay significantly more for a substantially identical downloaded product, when in their view the vendor incurred no higher costs in providing it. A representative sample

42 *Committee Hansard*, Canberra, 22 March 2013, p. 40.

of the views of concerned consumers expressed in submissions is presented below. Mr Stephen Delvecchio argued in his submission that digital distribution removes any reason for differential pricing:

The argument of increased costs due to shipping physical goods from overseas died the day we entered the digital age – many years ago. There is absolutely no reason why I should be charged up to \$50 more for the exact same 1's & 0's that are purchased from the exact same store just because I happen to have an Australian accent. The word absurd doesn't even come close to describing it.⁴³

3.58 Mr Samuel Lymn argued that:

... in all cases, when discussing digital product pricing, one can make no claim about increased costs for the retailer on the basis of things associated with preparing a physical product for sale. The fact that the product is digital completely eliminates such considerations.⁴⁴

3.59 According to Mr Duncan Wallace:

It could be argued that shipping and costs of operating physical retail stores in Australia cause prices to be higher. However, this does not apply to digital downloads of software.

In most cases, the customer is downloading exactly the same software, from exactly the same servers as other customers around the world. The customer also bears the expense of any bandwidth costs for the actual download.⁴⁵

3.60 Although the above are only three examples of many received, in this section the Committee canvasses the arguments made by IT companies and vendors in response to specific sectoral claims. The Committee acknowledges the view of Microsoft that even in the case of digitally distributed content, a vendor's costs may remain high:

Software that is delivered via an online portal offers the potential for reduced transaction costs for vendors in the way of distribution costs. Nevertheless the costs of providing the services - including establishing, maintaining, supporting and advertising the services - needs to be recovered and a profit from those operations derived.⁴⁶

43 Stephen Delvecchio, *Submission 12*, p. 1.

44 Samuel Lymn, *Submission 51*, p. 2.

45 Duncan Wallace, *Submission 19*, p. 2.

46 Microsoft, *Submission 67*, p. 3.

Music

3.61 The Committee heard conflicting views on who controls the price Australians pay for music, movies, books and other copyright content. While many submissions were highly critical of Apple's Australian iTunes store pricing, Apple argued that the prices of music sold through that store is dependent on the wholesale prices set by the music labels:

The pricing of music, movies and TV shows on iTunes is determined by various factors. Prices are heavily influenced by the wholesale price set by the labels and studios, royalties payable for the use of musical compositions and the incorporation of local taxes.⁴⁷

3.62 Mr King told the Committee that:

The iTunes store is a digital media store. Apple must pay the rights holders of the digital content – the record labels, movie studios and TV networks – to distribute content in each of the territories in which the iTunes store exists. The pricing of this digital content is based on the wholesale prices which are set through negotiated contracts with the record labels, movie studios and TV networks. In Australia they have often set a higher wholesale price than the price of similar content in the United States.⁴⁸

3.63 After many attempts to seek input from the Australian Recording Industry Association (ARIA), the Committee was advised that:

ARIA has no relevant information on how music prices are set in the Australian market. ARIA is not involved in the setting of wholesale or retail prices in the music industry - ARIA does not supply music to retailers or consumers. Nor does ARIA have access to information about how record companies or music retailers set their prices. It would therefore be inappropriate for ARIA to comment on price.⁴⁹

3.64 In its efforts to establish reasons for the apparently vastly higher costs to Australian consumers to access digitally downloaded music, the Committee had sought information from the Australian royalty collecting agencies, the Australasian Performing Rights Association and Australasian Mechanical Copyright Owners Society Ltd (APRA-AMCOS). The Committee heard from Mr Richard Mallett, Head of Revenue, that:

47 Apple, *Submission 62*, p. 1.

48 *Committee Hansard*, Canberra, 22 March 2013, p. 2.

49 Australian Recording Industry Association, *Submission 93*, p. 1.

... it is public knowledge that out of each sale of a single track download the DSPs [Digital Service Providers] will generally keep up to 30 per cent, the record labels will receive between 60 and 70 per cent and APRA-AMCOS receives nine per cent. APRA-AMCOS's rate in Australia is similar to tariffs in operation in other territories. For example, in the UK and Europe it is eight per cent, in Canada it is nine per cent and in the USA it is US9.1c, which is a fixed rate irrespective of sale price.⁵⁰

- 3.65 Given the 'public knowledge' of this matter, the Committee was therefore surprised to hear from the Managing Director of ARIA, Mr Dan Rosen, that in relation to the division of the revenue obtained from music sales:

I think that is something that is split between the retailer and wholesaler. I do not know the details of that split. Then, within that, I do not know how they split that up. I would assume each artist has their own relationship and have a contract with their label on how that gets divided...

I think you would need to speak to a range of retailers, because there is an enormous number of different retailers in Australia, and a range of rights holders. Some of those rights holders would be in Australia and some of them would be overseas.⁵¹

- 3.66 The Committee continued to seek accurate and transparent advice as to pricing, and invited submissions from rights holders. Universal Music Australia (UMA) maintained in its submission that prices were set by the retailer:

The retail price charged to consumers by Australian digital providers is set by the particular digital provider. UMA has no say in the setting of that retail price. UMA provides its content to retailers according to wholesale price rate cards. UMA has rate cards that apply to physical records and rate cards that apply to digital content. The rate cards set out the prices of the different album and track pricing tiers with multiple tiers being offered. Rates for campaign discounts, which are commonly demanded by digital retailers as a condition for including particular products within a promotional campaign, are also included. There are further categories for deluxe products, compilations and video products.⁵²

50 *Committee Hansard*, Sydney, 30 July 2012, p. 17.

51 *Committee Hansard*, Canberra, 5 October 2012, p. 3.

52 Universal Music Australia, *Submission 129*, p. 4.

- 3.67 Representatives of the Australian music industry also claimed that, even though much of their product is digitally distributed, the industry still incurs costs which must be recovered. ARIA argued that:
- ... the contention that digitally delivered content by a local company with an international parent is identical and should therefore cost consumers the same in Australia as in the US or some other country is unfounded.⁵³
- 3.68 According to ARIA, Australia-based national affiliates ‘must run as a viable business in their own right to optimize their activities in the interests of their shareholders (be they overseas parent entities or domestic individuals)’.⁵⁴ Mr Rosen stated that record labels incur many costs in producing music and that the idea that digitally delivered products are cost-free is an ‘incorrect assumption:’
- I think that is a misconception because in Australia these businesses are running with local costs – wages, property and, importantly, marketing. There is also what we in the music industry call A&R. This is the R&D of the music industry which goes into sourcing local talent... This is an incredibly important part of what the label members do in Australia. It is a costly exercise and it is something that they are doing in this country.⁵⁵
- 3.69 Universal Music Australia outlined its costs in this way:
- UMA invests heavily in Australian artists as well as providing significant funding to a number of independent Australian labels. In addition, the company carries substantial labour and operating costs. All of these investment and operating expenses must be covered by UMA’s local revenues. In addition, once an artist’s album has been recorded, UMA must invest heavily in the marketing and promotion of such album. It is vital to an album’s success for UMA to achieve local media support including radio play, videoclip play and online exposure. UMA also invests heavily in television and radio marketing campaigns.⁵⁶
- 3.70 As mentioned in chapter 2, the Committee is aware of the emergence of streaming services in the music market. In October 2012, Mr Rosen advised the Committee that eight or nine services, including Spotify, had been launched in the previous 12 months.⁵⁷

53 Australian Recording Industry Association, *Submission 93*, p. 2.

54 Australian Recording Industry Association, *Submission 93*, p. 2.

55 *Committee Hansard*, Canberra, 5 October 2012, pp. 2-3.

56 Universal Music Australia, *Submission 129*, p. 5.

57 *Committee Hansard*, Canberra, 5 October 2012, p. 4.

- 3.71 Apart from describing the growing number of choices for consumers to access content, music industry organisations have argued that the cost of music in Australia has fallen significantly over the past decade, as have revenues of record companies and the music industry more generally. UMA argues that recorded music in Australia is ‘cheaper than ever’.⁵⁸
- 3.72 UMA claimed that revenue had more than halved in the period 2003-2011, as a result of the ‘prevalence of illegitimate music downloading and streaming platforms’, which has led to a decline in the willingness of consumers to pay for music.⁵⁹ ARIA cited the ‘abundance of free or near-free services’ as a factor driving down prices, but considered the impact of copyright infringement to be of primary importance:
- Australian consumers have access to a plethora of unchecked and unregulated web-based suppliers that offer a very wide range of pirated music at no charge. Digitalisation has enabled piracy on a massive scale, so much so that the wholesale revenues of record companies have been almost halved in the last 11 years ... Piracy accounts [for] a significant amount of the music consumed in Australia today.⁶⁰
- 3.73 Copyright issues are considered further in chapter 4.

Games

- 3.74 As discussed in chapter 2, submissions from many consumers referred to the often significant price disparities imposed on Australian gamers when purchasing through digital distribution platforms like Steam.
- 3.75 Mr Matthew Kermeen found it ‘highly perplexing’ that games should cost so much more in Australia when purchased through digital distribution platforms. Mr Kermeen expressed frustration at paying ‘almost double the price for the exact same product, delivered in the exact same manner’, when localisation and distribution costs should be close to nil.⁶¹
- 3.76 In relation to the game *Diablo 3*, which cost more than 30 per cent more in Australia than in the US, Mr Zhiliang Huang wrote that:
- There is no difference in the way the game is delivered (by download) between a U.S. buyer and an Australian buyer.

58 Universal Music Australia, *Submission 129*, p. 6.

59 Universal Music Australia, *Submission 129*, p. 2.

60 Australian Recording Industry Association, *Submission 93.1*, pp. 1-2.

61 Matthew Kermeen, *Submission 48*, pp. 1-2.

The game will [also] be played [on a] U.S. server and there is no difference in the way the game will be played (on battle.net) between an U.S. buyer and an Australian buyer.⁶²

3.77 Mr Mark Sinclair summed up consumer frustrations in this way:

The big issue many Australian gamers have is the variation in price that we pay compared to other gamers in other parts of the world, no transport costs are necessary, every time a purchase is made you are only copying a file from a server, no additional production of disk or packaging is required, no additional cost to steam is incurred because we are across the Pacific, transport of the product is covered by the Australian consumer by our download allowance in the contract we have with our internet service provider, we also have a free trade agreement with the US. We are buying a product from this company in exactly the same manner as a US citizen, yet we Australian customers can pay up to double the price.⁶³

3.78 The Committee notes no representatives from the gaming industry chose to address this issue.

Books

3.79 Consumers who purchased e-books expressed their concerns about price discrimination. As Mr Daniel Myles said:

Australians are downloading the e-books from exactly the same place as the rest of the world. It's not as if the books sent to us through our internet connections magically increase in cost depending on where in the world it moves to. It's just bytes of data, 1s and 0s, identical and completely oblivious to a consumer's geographical location.⁶⁴

3.80 Ms Julie Jester concurred, noting that:

e-books do not have the costs associated with printing, distribution and retailing. Once an e-book is formatted, a single copy can be stored on a server anywhere in the world and distributed electronically at a trivial cost.⁶⁵

3.81 Mr Jeff Burgess noted, in relation to licensing books from Amazon, that:

62 Zhiliang Huang, *Submission 2*, p. 3.

63 Mark Sinclair, *Submission 23*, p. 1.

64 Daniel Myles, *Submission 33*, p. 21.

65 Julie Jester, *Submission 47*, p. 3.

There is no such thing as ‘an Australian Amazon website’. Buyers from every country, including Australia, all buy and download e-books from the same USA-based Amazon internet book store at www.amazon.com. There is therefore no technical reason for higher pricing of e-books for Australians.⁶⁶

3.82 Representatives of the Australian publishing industry indicated that publishers have ongoing costs regardless of the format their books are published in. Mr Ross Gibb of MacMillan Publishers Australia said:

... e-books cost so little to produce, so why are they not cheaper than what they are? In our business an e-book is just another format; it is not a separate stand-alone product. So the full cost of paying the author, commissioning writers and content, editing, designing, and marketing all still exist. These costs will not go away, even as the e-book market grows.⁶⁷

3.83 Mr Gibb told the Committee:

Today in the US, a market that is about three, possibly four years ahead of our market – it is very hard to tell with technology – e-books account for 16 per cent of total book sales. So 84 per cent of the book market remains in paper and the costs to maintain that business still exist. It is true there is no print cost in producing an e-book and there is no freight cost but digitising content, file and data storage, file distribution by third parties, and managing and combating piracy bring new costs to the business.⁶⁸

3.84 As in the case of digital music, the Australian Publishers Association (APA) also emphasised the regional nature of markets:

Profit margins on each e-book sold can also vary from country to country, depending on factors such as royalty structures, hosting costs, technical support provided by a publisher and the extent to which a book needs to be adapted and enhanced to suit each country (a particular concern in relation to educational publishing). [M]ost publishing of Australian titles is done on the basis that costs must be recovered in Australia, as the largest market for Australian titles.⁶⁹

66 Jeff Burgess, *Submission 49*, p. 3.

67 *Committee Hansard*, Sydney, 30 July 2012, pp. 10-11.

68 *Committee Hansard*, Sydney, 30 July 2012, p. 11.

69 Australian Publishers Association, *Submission 66*, p. 2.

Policies and approaches to pricing

3.85 Noting discussion to this point about impacts on costs in Australia, the Committee took a general approach to ascertain overall views of businesses to issues which may affect pricing decisions. Matters considered include observations on pricing models; elements of competition and choice; and managing a market (including through subscription models and geoblocking). The Committee notes Mr King's views that price discrimination begins at the wholesale level, and his argument that Apple would lower prices if it could:

When you boil it all down, where may a price differential arise? It is in the difference in the wholesale price to the retailer. The other costs are either variable in nature, such as the GST, or comparable in nature like the publishing fees or the iTunes store management costs...

We would love to see lower content prices, be it for songs, movies or TV shows. That would drive a wonderful use of our products within the Australian market. I want to make it absolutely clear that it is in our best interests to see that take place.⁷⁰

Approaches to regional pricing

3.86 Mr King responded to a question about price discrimination and companies charging 'what the market will bear' in the following terms:

We do, and have, for as long as I can remember run an overall model where we offer equivalent pricing on our products around the world. We establish that equivalent price at the time we introduce a product to a market. ... Simply put, we offer an equivalent pricing model rather than the model you are suggesting about what a market may bear. We start with a US denominated price. We do take into consideration some costs of doing business in a market. That may be in the area of freight. The per unit freight charge of an iMac, for example, is more expensive to bring into the Australian market than it is to other markets.⁷¹

3.87 Mr King subsequently explained that Apple 'set[s] our prices worldwide from Cupertino with input from the local team for factors that may be relevant for the Australian market. We have a global equivalent pricing model that is established at a worldwide level.'⁷²

70 *Committee Hansard*, Canberra, 22 March 2013, p. 3.

71 *Committee Hansard*, Canberra, 22 March 2013, p. 6.

72 *Committee Hansard*, Canberra, 22 March 2013, p. 10.

3.88 Asked whether Apple sets prices charged by its channel partners in Australia, Mr King, responded:

We establish a price on the Apple online store and through our retail stores for a product, but our partners are free to set their prices as they see fit in the market. Indeed, in any given week or month we see very highly competitive offers taking place with our channel partners across Australia. We have 6,000 sites that are within our rich ecosystem, and our partners are constantly driving innovation around the way that they provide value to customers. That will manifest itself in anything from a bundle to an offer and in some cases a discount, but that pricing is purely in the court of the retailer. It is their decision.⁷³

3.89 A different approach to pricing was set out by Adobe's Mr Paul Robson. In his evidence to the Committee, Mr Robson outlined a pricing strategy which is not global but regional in nature:

... Adobe seeks to set prices in this market here in Australia that provide a consistent contribution, taking into account the cost of doing business in this region and allowing us to run a regional operation. We do this in most markets around the world while at the same time trying to provide some uniformity across those regions.

...If customers do not feel that they are getting good value, they simply will not buy our products. Price is the key to competitive advantage which in turn underpins the global trading system.⁷⁴

3.90 Ms Marlow also outlined Microsoft's explicitly regional pricing approach:

At Microsoft, whilst we operate in over 100 countries around the world, we do not operate on a single global model. In fact, the countries that we operate in are very different, and therefore the way that we compete and the way that we deliver products and services every day in those countries can be unique. In those spaces, we work to make sure that we understand our customer's needs and the competition and, therefore, have a unique strategy, be it in the different countries or given the different competitive landscape that we have....

[W]e do not operate under a single global market model and there are a range of factors that do impact the way that we go into market. They may start with cost structure, customer perceptions,

73 *Committee Hansard*, Canberra, 22 March 2013, p. 8.

74 *Committee Hansard*, Canberra, 22 March 2013, p. 15.

partner choices but most importantly the competition that we have in market.⁷⁵

3.91 Ms Marlow later elaborated on this point:

We do not operate on a standard price because we do not believe that every market is the same. We may be selling to an emerging market, for example, where the cost of living, the availability of technology, the ability of customer perception and the competition might be completely different. ... We do not set them on a global market. We know that, in the end, because we are living with competition, our customers will vote, as I said before, with their wallets. If we make the price too high in that particular market, they have choice and they will look elsewhere. We respond to that.⁷⁶

3.92 The Committee received evidence from the Australian Home Entertainment Distributors Association (AHEDA) stating that:

The terms of the Inquiry seem to suggest that there are regional retail price differentials which are attributable to the pricing practices of international suppliers (ie wholesale pricing). However, retailers set their own pricing and average retail DVD prices suggest that they are broadly on par with those in Europe.⁷⁷

Competition

3.93 Asked whether it was Microsoft's approach to charge whatever a regional market would stand, Ms Marlow responded:

In a market where there is supply and demand in a free economy, yes, absolutely.⁷⁸

3.94 Competition within a free market, and the ability of consumers to make their own purchasing decisions was a common theme of IT vendors. Ms Marlow described the company's operation in a global free market:

We would say that, in the free market, you are going to see pressures come from competition and different areas, and we will continue to compete....

I believe we are not operating in a global economy where organisations need to have a global price. I believe companies should be able to lawfully set prices differently across the market

75 *Committee Hansard*, Canberra, 22 March 2013, pp. 31-32.

76 *Committee Hansard*, Canberra, 22 March 2013, p. 32.

77 Australian Home Entertainment Distributors Association, *Submission 58*, p.1.

78 *Committee Hansard*, Canberra, 22 March 2013, p. 35.

that works for their business strategy, works with the different investments they make in those different markets, works based on the competitors they have in those markets and on the customer perceptions in those markets in a true supply-and-demand manner.⁷⁹

- 3.95 Both Microsoft and Adobe argued that consumers and businesses can always turn to other products if their customers believe their prices are too high. Ms Marlow said:

[S]mall businesses in this country have choice. There are a plethora of products they can use. There are other products that they can use today for similar functions, and they have a choice to make. We operate in the market very lawfully. We are out there competing every day on price and on the service of product. ... If we price our products too high, then our customers will make different choices.⁸⁰

- 3.96 Asked by the Committee about customer perceptions of Microsoft charging Australian users of one Microsoft product more than 70 per cent more than users in the United States, Ms Marlow argued that the key issue was customer perception of Microsoft's products:

We look to measure our customer's delight and satisfaction with our company's products in a lot of ways. Often that is through sales. Every day we are out there selling our product, making sure that as you are using the variety of hardware that you have in front of you now that we are an eligible and competitive offering for our customers. Ultimately, the choice and the decision for customer satisfaction and delight is for the customer. I think the role of a free market and a company is to be able to then go out and compete every day to do that, to make sure that we through our products, through our support mechanisms and the things that we do every day when we are competing are the moment of value for our customers.⁸¹

- 3.97 However, in response to the suggestion that software vendors create 'digital handcuffs' that prevent consumers and businesses from switching to a competitor, Ms Marlow said:

Most of our software programs are built with interoperability in mind, so you can use tools to transfer data and technology. ... We have to keep building on those products, keep making sure we

79 *Committee Hansard*, Canberra, 22 March 2013, pp. 35-36.

80 *Committee Hansard*, Canberra, 22 March 2013, p. 38.

81 *Committee Hansard*, Canberra, 22 March 2013, p. 32.

compete and innovate, keep making sure that we deliver the value they want, because they do have those choices in this market.⁸²

- 3.98 However consumer groups argued that market forces are rather less than perfect in relation to IT products. As the Australian Communications Consumer Action Network (ACCAN) observed in its submission to the Committee:

Software has different economic properties to many other products. Due to compatibility issues, unless there are uniform standard allowing multiple software products to access and edit files from different programs, the value of software increase with the number of people using that product. Market power then tends to reside in a few powerful organisations.⁸³

- 3.99 ACCAN elaborated, using Adobe's software products as an example:

Adobe has significant market power due to its importance to creative industries. It also structures products in such a way that requires regular investment (through purchasing upgrades and linking products) that make the cost of switching to another piece of software more expensive. This market power would appear to allow Adobe to undertake international price discrimination to the detriment of Australian small business, many of whom have little choice about what product they are able to purchase.⁸⁴

Managing markets

Cloud and subscription services

- 3.100 In evidence to this inquiry, industry groups highlighted the utility cloud services offer for consumers and businesses, especially the potential to reduce IT support costs for businesses and consumers by outsourcing hardware and software maintenance and support. According to the Australian Industry Group (Ai Group), for example, cloud computing enables monthly or annual pay-as-you-go pricing models for customers which can be scaled up or down flexibly depending on customer demand.⁸⁵ AIIA CEO Ms Suzanne Campbell similarly argued that the cloud provides pricing advantages for Australian consumers and businesses:

82 *Committee Hansard*, Canberra, 22 March 2013, p. 38.

83 Australian Communications Consumer Action Network, *Submission 74*, p. 8.

84 Australian Communications Consumer Action Network, *Submission 74*, p. 8.

85 Australian Industry Group, *Submission 56*, p. 2.

Cloud presents opportunities. In relation to pricing, cloud based pricing for a product means that consumers no longer need to secure a licence to own the product outright; they can use it on an as-required basis – pay as they go or pay per month. So that is one innovation that comes with cloud. More generally, as a business model, the enabling capacity of cloud relates to lower capital costs, easier access to platforms – and is a particularly significant opportunity for SMEs.⁸⁶

3.101 Mr Robson repeatedly expressed Adobe’s view that its cloud-based subscription service – called ‘Creative Cloud’ – provided significant advantages for Adobe customers including more frequent software updates instead of an annual or biannual version release (as is the case when purchasing perpetual-license software):

... Creative Cloud provides access to continual updates, enhancements and new features of our technology over time... if you bought a copy of Photoshop prior to there being a new operating system in the marketplace or prior to there being a new piece of hardware, such as a tablet or a smartphone, the technology that you purchased would support the technology that was available in the market at that point in time. It is a snapshot of the tech landscape. But by being able to provide a Creative Cloud offering it allows us to then provide enhancements and updates to customers throughout all innovation across the technology landscape. So as other vendors bring hardware or new operating systems to the market our customers get recurring updates and enhancements to our technology.⁸⁷

3.102 Mr Robson went on to highlight special features available to customers via Adobe’s cloud services:

We add features to Creative Cloud that we technically could not offer otherwise. Some features exist in Creative Cloud that you would not get access to if you were to buy a box product, including collaborative services that allow you and I, for instance, to share files and information. It allows us to provide storage to our customers. It allows online storage. It allows them to easily share that content with other parties. It also allows them to sync across multiple devices.⁸⁸

86 *Committee Hansard*, Canberra, 30 July 2012, p. 3.

87 *Committee Hansard*, Canberra, 22 March 2013, p. 17.

88 *Committee Hansard*, Canberra, 22 March 2013, p. 18.

- 3.103 Mr Robson argued that price differentials for new Adobe products are much lower than in the past. In particular Mr Robson highlighted prices for Adobe's 'Creative Cloud' subscription-based service:

Creative Cloud was launched in April 2012 and we have been monitoring and reviewing its performance in markets since its launch. Last month we made the decision to change the monthly price of creative cloud to \$49.99 on an annual subscription basis. This brings the price in Australia broadly in line with the price in the United States. Historically the price of our student and teacher offering for this cloud based service has been lower in Australia and New Zealand than in most markets around the world and is priced at \$24.99.⁸⁹

Geoblocking

- 3.104 The practice known as 'geoblocking' has been discussed earlier. The Committee notes that many major IT companies regard geoblocking as a legitimate tool which allows them to set prices in regional markets. Mr Robson explained that:

I am sure you are all aware that geoblocking is a well-established and legal practice seen across many industries. At Adobe we do direct our customers to country-specific websites via what we call 'automatic redirection'. We do this for a variety of reasons, including the ability to recover the costs of delivering a local, personalised and relevant experience for customers. Our customers expect to see marketing, discounts, post-sales support and other information that is customised to their local market. We also do it to ensure that we comply with local legal requirements.⁹⁰

- 3.105 Ms Marlow outlined Microsoft's approach to geoblocking in the following terms:

We do use geoblocking as a lawful mechanism to manage our business, as some of our competitors and other companies do. ...We use geoblocking in a number of different ways. We would use it to ensure we comply with local ratings for games. In different jurisdictions and geographies games will have different ratings, so we will make sure that we manage to that. We would use it to manage licensing arrangements on content, which differ from geography to geography. We would use it to make sure that we can adapt our business strategies, which might be different

89 *Committee Hansard*, Canberra, 22 March 2013, p. 15.

90 *Committee Hansard*, Canberra, 22 March 2013, p. 15.

from geography to geography. And we would do it to understand what is happening in our own local geographies to make sure that we can make investment decisions to support the consumer demand in those different types of geographies.⁹¹

- 3.106 Issues surrounding the use of technological protection measures (TPMs) and geoblocking will be explored in further detail in chapter 4.

Consumer views on cost claims

- 3.107 The Committee heard evidence from consumers and consumer groups which disputed industry evidence in relation to higher costs. The Choice submission made the following assessment of the likely impact of these costs on the price of IT products in Australia:

There is no evidence that factors such as wages and labour costs, occupancy costs and rent, GST, retail profit margins, and logistics and transportation can, even cumulatively, account for some of the price differentials identified in IT hardware and software products.⁹²

- 3.108 Mr Matthew Levey from Choice elaborated on these conclusions in evidence before the Committee:

I do not think we deny that there are factors which are specific to doing business in Australia – I am sure there are, just as there are factors specific to doing business everywhere – but on the basis of what has been put forward, whether it is rent, marketing, labour costs or GST, we do not think that the proportionate higher costs of doing business in Australia in any of those areas can amount to a 50 per cent or greater price difference. Therefore, the only place we can look to is the wholesale cost of that product, which would be set by the manufacturer, the international copyright holder of that product.⁹³

- 3.109 In relation to the idea that costs associated with warranty support are driving the price of IT goods up in Australia, Mr Levey argued that there is evidence that Australian retailers can combine low prices with strong warranty support:

... when you look at some parallel importers like Kogan, the TV parallel importer, who, as far as we understand it, has an

91 *Committee Hansard*, Canberra, 22 March 2013, p. 35

92 *Choice, Submission 75*, p. 26.

93 *Committee Hansard*, Sydney, 30 July 2012, p. 23.

extremely strong refund/return policy you will see that, even though the goods that it is selling are parallel imported so you would assume not covered by that manufacturer's domestic warranty requirements, it obviously shows it is quite possible to operate here profitably, sell a lot of products and still offer significant price savings compared to what, if you like, the official supply chains would provide.⁹⁴

- 3.110 Some consumers met the notion of warranty and aftersales support costs driving higher prices with scepticism. According to Mr Magnus Stensson:

I would argue that Australia generally has the worst warranty service in existence. I buy IT hardware from the US or Hong Kong and get better warranty than here, where the trend is to make things as complicated as possible.⁹⁵

- 3.111 Mr Christopher Shain also expressed doubts at the extent to which warranty costs could contribute to higher IT prices, in particular pointing to the trend toward offshore technical support centres:

There are obviously some examples where getting physical support may incur extra costs, but often to nothing like the extent of the price disparity.

For software products particularly, if the service and support was any different, of better quality or easy to obtain then I could understand a price difference, but my personal experience over many years in getting support and backup for professional imaging software related issues is that I'm usually not speaking with someone that's located in Australia anyway.⁹⁶

- 3.112 Evidence from consumers also notes that the multinational IT companies with which they do business are able to amortise many of the costs listed above by operating centralised support, billing and distribution services from a low cost offshore location. Mr Graeme Kitney also expressed doubts at the extent to which local costs could influence the price of his Adobe software:

Last year I wanted to upgrade my Adobe Acrobat and Adobe Photoshop Elements and went to their web site for the price and to order the upgrades. When I put in my address it directed me to their Australian site and the price increased two and a half times.

94 *Committee Hansard*, Sydney, 30 July 2012, p. 24.

95 Magnus Stensson, *Submission 71*, p. 1.

96 Christopher Shain, *Submission 57*, p. 1.

However this wasn't the end of my annoyance with Adobe, when the software arrived it had been posted from Singapore and I was billed from Dublin.⁹⁷

- 3.113 The Committee remained intrigued throughout the inquiry with regard to the apparent mismatch between industry statements and actions: industry organisations stated a willingness to assist the Committee but demonstrated a clear reluctance to do so. The Committee observed similar attitudes towards addressing consumer perceptions. In noting negative customer feedback, Apple's Mr Tony King told the Committee that:

We are acutely aware of customer feedback in general. ...[W]e are acutely aware of headlines that might be reported in the newspaper, or a letter we may receive from a customer who is concerned that a song price on iTunes in Australia may be more than in the US. I have a very frank and candid dialogue with my counterparts in the US to make sure that they understand this. Indeed, at a global level, within our iTunes teams, we do pass the observation to the global head office of a music label that we are hearing comments in Australia that frankly make us uncomfortable.⁹⁸

- 3.114 The Committee notes, however, that according to Dr Matthew Rimmer, an academic from the Australian National University, in relation to e-books and software sold through Apple's app store, content is sold under an 'agency agreement', according to which prices are set by the publisher or rights holder. In these cases the retailer acts as an agent and takes a percentage of each sale, but does not set the price. According to Dr Rimmer, Apple and a number of publishers are subject to an antitrust investigation in the United States as a result of price fixing concerns arising from the agency agreement.⁹⁹

Committee comment

- 3.115 Submissions to the inquiry indicate that Australian consumers have developed a strong impression that they are the subject of international price discrimination, in which overseas suppliers of IT products charge Australians substantially higher prices without obvious justification other than that it is 'what the market will bear'. The Committee shares this view.

97 Graeme Kitney, *Submission 117*, p. 1.

98 *Committee Hansard*, Canberra, 22 March 2013, p. 13.

99 Matthew Rimmer, *Submission 92*, pp. 73-79.

- 3.116 The Committee acknowledges that there are factors specific to the Australian market which can make it a higher-cost environment for IT vendors compared with other markets. Australia's population is comparatively small and spread over a large geographical area, which means that higher distribution, wage and occupancy costs must be covered by smaller unit sales than in a market like the US. There are therefore many products, primarily hardware products or those with a physical distribution model, for which costs are indeed higher than in comparable overseas markets.
- 3.117 That being the case, however, the Committee is of the view that in many instances these higher costs cannot, even cumulatively, explain the price differences consumers experience in relation to many IT products, and especially those delivered via the internet.
- 3.118 The Committee notes the views of some industry groups and major IT companies that price differentials are narrowing. The Committee also notes that the AIIA submission acknowledged that international price discrimination is practiced by some of the AIIA's members as a matter of course. The AIIA referred to this practice as 'a common business strategy necessary to maximise performance in a specific high-cost market such as Australia'.¹⁰⁰ The Committee is therefore disappointed that the AIIA has confused the issue by disputing the validity of consumers' price comparison data and by offering alternative claims about higher costs that may contribute to price differentials.
- 3.119 The Committee's view is reinforced by statements made by government and industry groups which characterise regional pricing differences as a tool used by IT companies and rights holders to maximise profit. The Committee acknowledges the argument made by IT companies that regional pricing arrangements are a legal business strategy and that companies making such arrangements are subject to competitive market forces. The Committee notes that Microsoft and Adobe both rejected the notion of a global market place and explicitly acknowledged that their pricing strategies reflect judgments as to what particular regional and national markets will bear.
- 3.120 The argument that 'sticky' exchange rates continue to affect prices became less persuasive as the inquiry proceeded. The Committee considers that price disparities that persist two years after parity with the US dollar are no longer explicable entirely by reference to exchange rates. Although the Committee is aware that a range of IT products, including Apple

100 Australian Information Industry Association, *Submission 73*, p. 4.

hardware, is now priced much closer to parity with the US, it notes that significant price discrepancies remain across a range of product categories.

- 3.121 The Committee notes the evidence provided by Apple Australia Vice President Mr Tony King to the effect that localisation costs for IT hardware do not represent a significant additional cost.
- 3.122 The Committee notes that despite industry claims that costs exist for the creation and marketing of digitally distributed content, vendors have not produced any evidence to explain why differentials are so high for such content. In relation to games, for example, the Committee has not received any evidence which explains why it is almost invariably cheaper for Australian gamers to purchase and ship physical media from the United Kingdom to Australia than it is to purchase a digital copy of the same game.
- 3.123 The Committee notes the suggestion from industry groups that price differences are in some way ameliorated by 'non-financial value' provided to consumers through discounts, convenience, or after-sales service. The Committee received many submissions from consumers and small businesses upset at what they saw as unfairly high prices, and who did not feel adequately compensated by the 'non-financial' aspects of their transactions. Although the Committee acknowledges that in some circumstances, non-financial factors may influence purchasing decisions, it is clear that in many circumstances they do not.
- 3.124 Given the evidence presented to the Committee of very large price differentials, it is difficult to avoid the conclusion that these practices amount to international price discrimination to the clear disadvantage of Australian consumers and businesses.
- 3.125 The Committee acknowledges that there is competition in the sale of IT products, however there are also significant barriers to competition and choice. Rights and their control also need to be considered. Copyright, competition and access are explored in the next chapter.