Chapter 3

Geographic price discrimination in Australia

What is geographic price discrimination?

3.1 Geographic (or 'spatial') price discrimination is a form of price discrimination. The economic literature identifies price discrimination as where a firm sells two identical units of a good at different prices, either to two different buyers or to the same customer.[1] A common example is the sale of identical tickets to an event which are priced lower for students and pensioners. Geographic price discrimination refers to the sale of an identical good (wholesale or retail) or service at a different price in a different location. It differs from 'price dispersion', which occurs when different sellers offer different prices for the same good in a given market.

3.2 In a 1987 book on pricing strategy, Dr Thomas Nagle referred to geographic price discrimination as segmenting by purchase location. He noted that 'dentists, opticians, and other professionals sometimes have multiple offices in different parts of a city, each with a different price schedule reflecting differences in their clients' price sensitivity'. He observed that many grocery chains classify their stores by intensity of competition and apply lower markups in localities where competition is most intense.

3.3 Dr Nagle also noted that price discrimination by location is quite common in international marketing. He gave the example of Deutsche Grammophon which has historically sold its records 'for up to 50 percent more in the European market than in the highly competitive American market'.[2] Another example are the region codes applied to DVDs which allow movie studios to charge different prices in different parts of the world without customers being able to buy DVDs where they are cheapest. The region codes thereby enable price discrimination.

Supermarkets' pricing policies in Australia

3.4 In March 2008, ALDI became the first grocery retailer in Australia to introduce a national pricing policy across all its stores.[3] Its website claims that through this strategy, the company is 'keeping things fairer for all Australians'. ALDI cited a

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1 *The New Palgrave Dictionary of Economics*, Second Edition, p. 626. Much of the economic literature employs a terminology introduced by A Pigou in *The Economics of Welfare*, (1920, Part 2, Chapter XVII) under which geographic price discrimination is a type of 'third-degree' price discrimination as it involves discrimination between consumers rather than between purchases of an individual consumer; see IPA, *Submission 4*; H Varian, 'Price discrimination' in R Schmalensee & R Willig (ed) *Handbook of Industrial Organisation*, Volume 1, 1989, p 600 and L Phlips, *The Economics of Price Discrimination*, 1983, pp 11-13.

2 Dr Thomas Nagle, S*trategy and tactics of pricing*, Prentice-Hall, New Jersey, 1987, p. 159.

3 This excludes excluding fresh fruit, vegetables and regional bakery lines.

recent poll it had conducted which found that '83 per cent of Australians were unhappy with the way supermarket prices vary from suburb to suburb'.[4] In its submission to this inquiry, the Institute of Public Affairs noted that geographic price discrimination is widely viewed as being 'somewhat immoral'.[5]

3.5 Coles and Woolworths have different arrangements. The head office of the major supermarket chains sets the shelf prices for most of its products in each of its stores. It also sets promotional prices, although not all stores necessarily have the same promotions at any one time. The local store manager can reduce prices below the standard shelf price in a range of circumstances including clearances of discontinued stock and stock approaching its use-by date.[6]

3.6 At a public hearing on 28 October 2009, the Senate Economics References Committee took evidence from both Coles and Woolworths representatives as part of its inquiry into the GROCERYchoice website. Mr Robert Hadler, General Manager of Corporate Affairs at Coles, told that committee that Coles gives its store managers the discretion to compete with their competitors' prices. In their submission Coles argued that:

> Compliance with the Bill for medium to large businesses would be so onerous that it would create the likelihood of a general reluctance to engage in existing discounting practices. The Bill would also significantly affect the ability of retailers to respond quickly to prices offered by their competitors. Coles considers that preserving the dynamic nature of retail pricing is fundamentally important to maintaining a highly competitive retail market.
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> Compliance with the Bill would necessitate retailers adopting homogenised prices for identical items across most or even all of their respective sites. The likely effect of this would be that retailers would adopt price points at the upper end of their existing pricing bands. This is a result that would not be in the best interests of consumers.[7]

3.7 ANRA told this committee that:

> The prices within the same chain can be quite different. Having asked our own customers why this practice occurs, the response that has been given to me by the national retailers is simply that discretion is given generally to the store manager to engage in whatever discounting he feels appropriate to be able to maintain his stock levels. He has a certain degree of freedom in eliminating certain stock. Head office does not prescribe those costs and in fact probably does not find out about those costs until they have been reported through the normal business communication channels. There is

4 http://www.aldi.com.au/au/html/ALDI_national_pricing.htm.

5 IPA, *Submission 4*, p. 1.

6 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 467.

7 Coles, *Submission 5*, p. 2.

this dynamic flexibility at store level which is simply a managerial function.[8]

The ACCC report on grocery prices

3.8 The July 2008 ACCC report into the competitiveness of retail prices for standard groceries contains an empirical analysis of Woolworths' and Coles' local store pricing.[9] The aim of the study was to analyse the effects of local competition in grocery retailing. The ACCC compared the prices consumers paid for the same products in different Woolworths supermarkets and, in a separate exercise, compared the prices consumers paid for the same products in different Coles supermarkets.[10] It did not compare Woolworths with Coles prices.

3.9 The ACCC report found that:

- the local presence of a competing supermarket (Coles or Woolworths) has a significant effect on Woolworths' and Coles local pricing. In 2007, consumers shopping at Coles stores with a Woolworths supermarket within one kilometre paid prices that were on average 1.36 per cent lower than the prices paid by consumers at Coles stores without a Woolworths within five kilometres;
- the local presence of an ALDI store lowers considerably the prices consumers pay at the nearby Coles or Woolworths. In 2007, customers shopping at a Coles store with an ALDI within one kilometre paid prices for Coles 'ALDI price check items' that were on average around 5.15 per cent lower than the prices for the same items paid by consumers at Coles stores without an ALDI within five kilometres;
- Woolworths is moving to more uniform pricing across most of its stores. As a result, the local presence of a Coles supermarket on Woolworths local pricing was smaller in 2008 than in 2007. The local presence of an ALDI store still affects Woolworths' local pricing but only for those products that have not been subject to more uniform pricing;
- Coles head office sets lower prices for certain products in stores that have an ALDI store in close proximity. These are mainly products that Coles considers to be comparable to products offered by ALDI; and
- local pricing of Coles and Woolworths' supermarkets has been influenced by discounting to attract customers to a new store, higher transportation costs for

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8 Dr Brendan Long, *Proof Committee Hansard*, 25 September 2009, p. 17.

9 The study's findings were presented in Appendix D of the *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008.

10 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 467.

remote stores and varying costs of sourcing and distributing products from local distribution centres.[11]

3.10 The ACCC noted that while there is a high degree of standardisation of shelf products across stores, the major supermarket chains:

> …do vary these prices based on factors including freight costs (especially for remote stores) and the degree of competition.[12]

3.11 The continuing presence of geographic price discrimination is indicated in the GROCERYchoice website which was established by the federal government in August 2008 to monitor and compare grocery prices for typical shopping baskets. The ACCC collected grocery price information in 61 regions across Australia. The website—which has now been discontinued—explains that the regions were established 'to ensure GROCERYchoice is relevant to all Australians' by reflecting 'the lifestyles and shopping practices of Australian consumers'.[13]

3.12 The practice of varying prices for the same product between regions is also apparent from the websites of Coles and Woolworths. Both companies' websites offer their catalogues and weekly specials by requiring the user to enter a postcode. Prices may differ according to the postcode, although the basis for these differences is not clear.

3.13 As part of its inquiry into the GROCERYchoice website, the Senate Economics References Committee asked Woolworths to comment on the discretion that individual store managers have to vary their prices (other than discounting perishables). Woolworths responded that its:

> …store managers can match a price on any product they think places the store at a competitive disadvantage (compared to other retailers in the area) in particular remaining competitive on key value items.[14]

3.14 The References Committee also asked Woolworths the extent of, and the reasons for, cost differences in the price of products sold at its different chains. Woolworths responded that while 'it has many thousands of products with uniform prices', these are mostly for dry grocery items. For fresh foods, such as fruit and vegetables:

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11 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, pp. 473–478.

12 Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 467.

13 'GROCERYchoice', http://pandora.nla.gov.au/pan/87702/20080807-0955/www.grocerychoice.gov.au/Default.html (accessed 18 September 2009).

14 Senate Economics References Committee, *Response to question on notice*, Woolworths, 11 November 2009, p. 3.

> …prices frequently and unpredictably fluctuate on the basis of factors such as availability, quality, competition, stock levels, etc. Thus, despite Woolworths' uniform national pricing, the base price fluctuates over the course of each week with the prices of over thirty percent of products moving up or down at various times in different stores to reflect factors such as supplier cost changes, weekly or daily specials, competition matching centrally or at individual store discretion etc.[15]

3.15 A separate analysis seems to support the finding that prices differ more for fresh fruit and vegetables than for packaged produce. On 10 May 2008, Mr Craig Kelly, President of the Southern Sydney Retailers Association, recorded prices for a basket of 26 fruit and vegetables at Woolworths in Fairfield in western Sydney and, an hour later, at the closest Woolworths in the neighbouring suburb of Greystanes. Mr Kelly's bill at Woolworths in Fairfield came to $45.72. For the same items at Woolworths in Greystanes, his bill was $105.54.[16]

3.16 Mr Kelly noted in his submission that the quality of the items he purchased at both supermarkets was identical. He gave the example of a one kilogram bag of red onions which had the same packaging, labelling, barcode and use by date with the Woolworths in Greystanes charging a 112 per cent higher price than the Woolworths in Fairfield.[17]

3.17 Mr Kelly noted in his submission and in verbal evidence to the committee that the low prices in Fairfield had driven a neighbouring independent green grocer out of business. Twelve months later, in May 2009, he returned to Woolworths in Fairfield to purchase the same 26 items. He found that Woolworths in Fairfield had increased its prices 'on average 80 per cent after the independent was driven from the market'.[18]

3.18 The committee has some concerns with this research. In particular, the 2008-09 comparisons for Woolworths Fairfield are inflated by a few items which should probably have been excluded from the analysis. For example, the 80 per cent increase in prices across the basket as a whole includes a 181 per cent increase in the rice of Navel oranges, a 231 per cent increase in the price of longans and a 436 per cent increase in the price of garlic. [19]

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15 Senate Economics References Committee, *Response to question on notice*, Woolworths, 11 November 2009, p. 2.

16 Mr Craig Kelly, *Submission 12*, p. 5.

17 Mr Craig Kelly, *Submission 12*, p. 5.

18 Mr Craig Kelly, *Submission 12*, p. 8.

19 See *Proof Committee Hansard*, 25 September 2009, p. 3.

Petrol retailers' pricing policies

3.19 In its December 2007 report into petrol prices, the ACCC noted that wholesale prices available to customers in Australia vary considerably. The report noted various reasons for these price differences including the discounts and more favourable terms offered to larger players and the exclusive supply arrangements between the supermarkets and respective suppliers.[20]

3.20 The ACCC report also recognised that geographic price discrimination exists as some petrol retailers adopt strategies to capitalise on the lesser competition in some areas. It noted that:

> Company data also shows that margins in regional areas are generally higher than in metropolitan cities. Higher margins in country areas has affected the strategy of some businesses such as United Petroleum, which states that it is looking to expand its business by focusing on regional rather than metropolitan sites because there is less competition, lower volumes and higher margins in regional areas.[21]

3.21 In his submission to this inquiry, Associate Professor Zumbo noted that the website www.motormouth.com.au shows:

> …that the same oil company and Coles and Woolworths operated service stations sell petrol at different prices at different locations, not only across a geographic area, but also along and across the very same street. These price differences reflect local competition, with lower prices being found in price competitive local markets.[22]

He noted that the data from the website revealed 'no necessary link' between lower retail petrol prices and a service station being closer to a terminal or refinery, and no necessary link between lower retail prices and 'lower cost' suburbs having lower occupation costs.[23]

3.22 At the public hearing on 25 September 2009, the National Association of Retail Grocers of Australia (NARGA) tabled two photographs of Caltex/Woolworths petrol stations on opposite side of Parramatta Road in Burwood, Sydney. NARGA

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20 Australian Competition and Consumer Commission, 'Petrol prices and Australian consumers—Report of the ACCC inquiry into the price of unleaded petrol', December 2007, p. 113 and p. 126. http://www.accc.gov.au/content/item.phtml?itemId=806216&nodeId=8185570f0f6244d5f20d18d7bc37d1e3&fn=Chapter%208%20Price%20determination%20and%20competition%20at%20the%20wholesale%20level.pdf (accessed 22 September 2009).

21 Australian Competition and Consumer Commission, 'Petrol prices and Australian consumers—Report of the ACCC inquiry into the price of unleaded petrol', December 2007, p. 113 and p. 139.

22 Associate Professor Frank Zumbo, *Submission 11*, p. 3.

23 Associate Professor Frank Zumbo, *Submission 11*, p. 3.

estimates that the two locations are 'about 70 metres apart'.[24] The first photograph, taken at 12.15pm, showed the price of 'Discounted Unleaded' fuel at 125.9 cents a litre. The second photograph, taken at 12.16pm, showed the price of 'Discounted E10' at 122.9 cents a litre.[25]

3.23 Mr Ken Henrick, Chief Executive Officer of NARGA, added:

> The picture we did not get was when we were going back to our office in fairly heavy traffic and could not stop, but there is another Woolworths service station at Roselands on King Georges Road…The price there was 109.9, the reason being that it is right next door to a Mobil service station. The petrol price inquiry which the ACCC conducted said that the average profit margins for the petrol industry are 4.9 cents per litre. So that is a difference between the Roselands store and the other two of 13 or 16 cents per litre, which would seem to suggest that it may be predatory.[26]

3.24 NARGA argued in its submission to this inquiry that the large petroleum retailers 'appear to have a substantial price advantage' in addition to which 'they can adjust their prices across the outlets they control to apply competitive pressure as and where they choose'. It gave the example of a petrol retailer charging higher prices at its stations along the Princess Highway the further south from Sydney they are sited.[27]

3.25 The Service Station Association claimed that its members are 'particularly disadvantaged' by geographic price discrimination. The Association noted that the large industry participants have large and widespread networks of outlets and added:

> It is common practice for them to vary the price at which they sell their petrol to suit the nature of competition at each location. It is the norm, and has been for quite some time, that the large retailers will set lower prices in more competitive areas and higher prices where competition is absent. The key point here is that the price is determined by the competitive nature of the market, not by the socio-economic status of the area. For example, the lower north shore of Sydney maintains a competitive price structure even though it has a very high socio-economic status. It exists because of diversity of competition in the region.[28]

3.26 The Association claimed that large retailers could subsidise lower prices in competitive areas by setting higher prices in areas of ineffective competition. It alleges that the common effect of this cross subsidy is that independent operators are priced out of the market. However, the Association was cautious in its support for the bill, calling for an examination of similar legislation in other jurisdictions to check for

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24 Mr Ken Henrick, *Proof Committee Hansard*, 25 September 2009, p. 26.

25 NARGA, *Tabled documents*, 25 September 2009.

26 Mr Ken Henrick, *Proof Committee Hansard*, 25 September 2009, p. 26.

27 NARGA, *Submission 6*, p. 3.

28 Service Station Association, *Submission 1*, pp. 1–2.

any unintended consequences. It also expressed concern that the bill would involve high compliance costs which may outweigh the benefits of the legislation.[29]

Committee view

3.27 The committee believes that the Blacktown Amendment, and the issue of geographic price discrimination, reflects legitimate concerns about the concentration of Australia's retail grocery and petrol markets. There is an important debate about the costs and benefits of having only two players owning a significant share of Australia's retail grocery market, and addressing the barriers to entry of new Australian and foreign competitors.

3.28 In this context, the committee welcomes the recent moves by the ACCC to remove restrictive clauses in rental tenancy agreements in shopping centres. More consideration should be given to similar types of reform with a view to encouraging greater local competition for the major chains. It is encouraged by the federal government's recent announcement that it will work through the Council of Australian Governments to free up restrictive planning laws. The available empirical evidence suggests that the presence of a second and third competitor in close proximity can deliver lower prices for consumers.

The lack of adequate research

3.29 The committee is surprised how little conceptual and empirical work has been done on the economic theory of geographic (or 'spatial') price discrimination in retail markets and its welfare effects. As Phlips has noted: 'discrimination might be as common in the marketplace as it is rare in the economics textbooks'.[30]

3.30 To the committee's knowledge, there has been no comprehensive empirical study in Australia of the extent of, or the reasons for, geographic price discrimination.[31] This inquiry has produced some claims as to why a company might price differently at its different sites:

- Coles listed several factors in its submission including freight, utility, rent and wage costs, different wholesale prices in different regions and 'subtle quality distinctions' for fresh food;[32]
- Woolworths downplayed the influence of freight costs, noting that 'only a handful of Woolworths stores in the remotest parts of Australia have marginally higher prices due to the extra transportation required';[33]

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29 Service Station Association, *Submission 1*, p. 2.

30 L. Phlips, *The Economics of price discrimination*, Cambridge University Press, 1983, p. 7.

31 The ACCC's 2008 inquiry into the competitiveness of retail prices for groceries in Australia did contain some useful information on the major supermarket chain's pricing strategies.

32 Coles, *Submission 5*, p. 4.

- ANRA explained price differences across stores in terms of stock management, with store managers given discretion to price according to the supply and demand for a product at the store; and
- Associate Professor Zumbo, NARGA and the Southern Sydney Retailers Association saw the rationale as the company wanting to maximise its profits by keeping prices high in uncompetitive locations and lower in areas of high competition.

3.31 These explanations may all have merit. However the committee has had very little evidence of either a qualitative or quantitative nature to indicate why a company does vary its price from one store to another. Without this analysis, it is difficult to quantify the problem that the bill seeks to address.

33 Senate Economics References Committee, Woolworths, *Answers to questions on notice*, 10 November 2009.