AUSTRALIAN INDUSTRY

GROUP

AUSTRALIAN INDUSTRY GROUP SUBMISSION

House Standing Committee on Infrastructure and Communication

Inquiry into IT Pricing

6 July 2012

EXECUTIVE SUMMARY

The Australian Industry Group (Ai Group) welcomes the opportunity to provide a submission to the House Standing Committee on Infrastructure and Communications' IT Pricing Inquiry.

Ai Group is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing; engineering; construction; automotive; food; transport; information technology; telecommunications; call centres; labour hire; printing; defence; mining equipment and supplies; airlines; and other industries. The businesses we represent employ more than 1 million employees.

Ai Group's interest in the inquiry reflects both its high proportion of members in the technology sector and its numerous members outside the sector who use IT products and services. Section one of this submission provides an economic context for IT hardware and software pricing in Australia. Section two examines factors that impact on pricing. It also considers the productivity benefits arising from investment in new technologies and potential barriers to business investment. Section three considers options for relieving pricing pressures.

The submission concludes:

- Product pricing is an issue for the market and general competition and consumer law.
- Business and consumer customers are price conscious and can shop around for IT software and hardware products.
- The range and capabilities of IT hardware and software products have expanded considerably in recent years, leading to greater variety in purchasing and pricing options.
- The electronics retail sector has been under pressure and IT hardware prices have generally been decreasing over the past year.
- Product pricing is affected by a number of factors including local regulation and standards, wholesale and distribution costs (i.e. freight, transport and storage costs), wage and other labour costs, rent and other occupancy costs, insurance costs, and government taxes. Consumer demand and levels of competition are also factors.
- Price is not the only factor influencing IT hardware and software purchasing decisions. Customers are also influenced by reliability and warranty considerations, convenience and after sales care.
- Australia regulates products to ensure they are safe and reliable and to minimise products' environmental impacts. These regulations and standards impact on price and can differ from other markets.
- Competition from non-compliant or counterfeit goods, which can be offered at a lower price compared to compliant goods, are another source of pressure on legitimate suppliers and retailers.
- Governments can play a role in relieving price pressures by monitoring the overall regulatory burden and taxation settings and working to harmonise regulatory approaches in international forums.

Section One: Economic context for IT pricing in Australia

The Inquiry has asked for comment on the price of a range of IT hardware and software products in Australia by comparison to other markets to identify if price differences exists.

As a general comment, Ai Group notes the difficulty of undertaking an accurate and comprehensive comparison of pricing in different markets. As the Productivity Commission (PC) acknowledged in the 2011 *Inquiry into the Economic Structure and Performance of the Australian Retail Industry*, snapshot price comparisons do not provide a complete guide to pricing in different markets or on different platforms. This is because the advertised prices or products may not reflect the actual prices that consumers pay, for example, if the consumer negotiates a lower price in store compared with the advertised price.[1]

Furthermore, snapshot comparisons do not take into account price discounts from the sale of bundled goods (such as a hardware and software package and combined software packages) or savings or discounts agreed between suppliers and customers during contractual negotiations. These models are common amongst business and Government customers.

Price comparisons also do not allow for non-price factors that may influence purchasing decisions, such as after sales service, convenience, reliability and preference for a trusted brand[2]. Price comparisons with products advertised on overseas websites also need to take into account compatibility with Australian requirements, for example, consumers may need to purchase additional connector plugs or adaptors for electronics goods purchased overseas and some computer games are not compatible with Australian expansion packs or supplements. Warranty requirements and after sales service options can also differ in each market.

Trends in the Australian Market

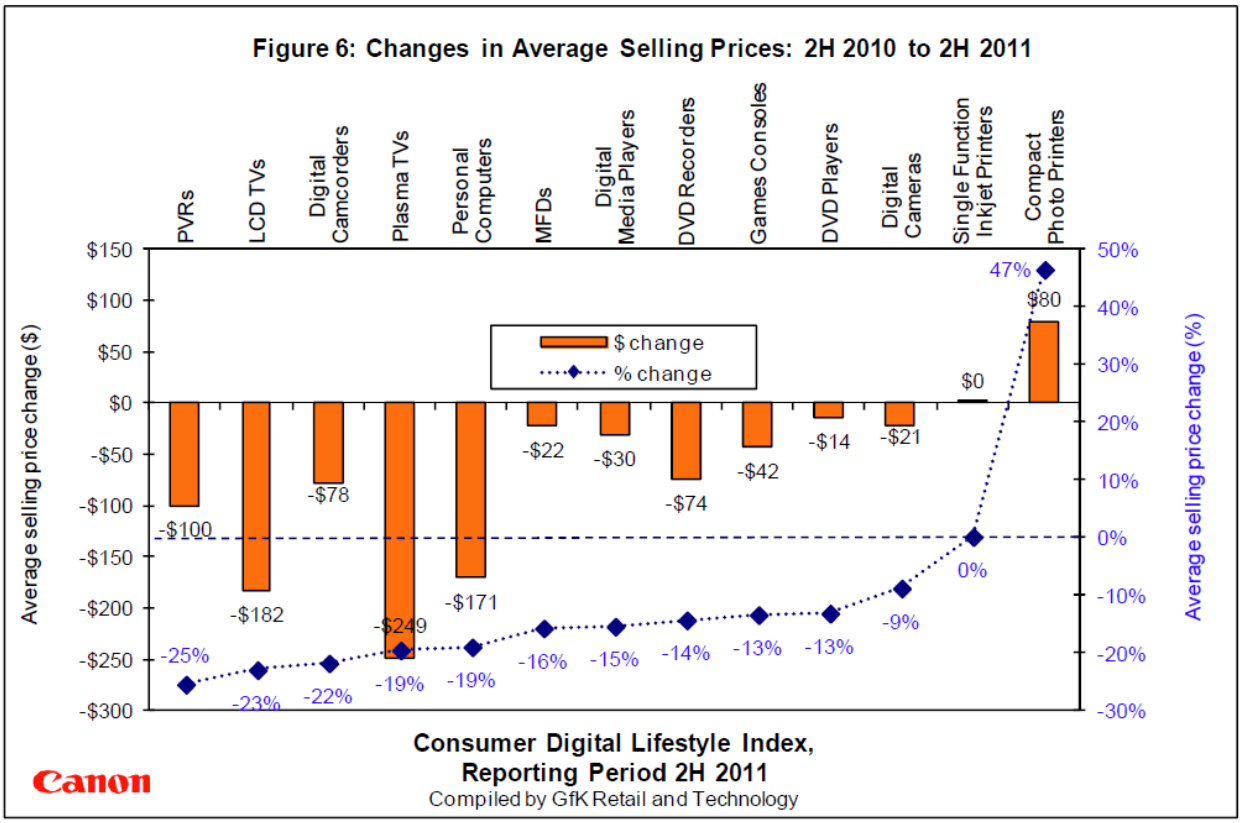
The range and capabilities of IT hardware and software products has expanded enormously in recent years. Trends such as cloud computing, software-as-a-service, multi-function devices and smart phones are changing the way that businesses utilise technology. A September 2011 IDC survey of Australian enterprises found that around 20% of respondents were using cloud-based services and 38% were testing or planned to deploy them over the next 6 – 12 months.[3] The 2011 Sensis e-business survey of SMEs found that 72% had a smartphone or internet connected phone and 16% owned a tablet device.[4]

Importantly, these trends are also expanding the range of pricing models available to customers and will increasingly offer opportunities for cost savings. 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.[5]

The price of IT hardware products has been trending down in the last twelve months in Australia. The Canon Digital Lifestyle Index recently compared changes in the average selling prices for key electronics products, based on GfK data, between the last half of 2010 and the last half of 2011. This analysis shows that the average prices of a range of popular consumer IT hardware products have decreased, including prices for personal computers (-19%), multi-function devices (-16%), and games consoles (-13%).

---

[1] Productivity Commission (2011), *Economic Structure and Performance of the Australian Retail Industry*, Report no. 56,
[2] Ibid, p. 145.
[3] IT Industry Innovation Council (2011), *Cloud Computing – Opportunities and Challenges*, p. 13.
[4] Sensis (2011), *Sensis e-business report: The Online Experience of Small and Medium Enterprises*, p. 7.
[5] Lehmann (S), Buxmann, P (2009), 'Pricing Strategies of Software Vendors', Business & Information Systems Engineering, Volume 1, Number 6, p. 454.



Source: Canon Digital Lifestyle Index (2012), p. 12

The price of electronic goods in Australia was also considered by the PC in the context of the 2011 inquiry into the retail sector. The PC undertook a snapshot price comparison of Australian retail and online prices for a range of goods. While in most cases the price of goods was higher in Australia compared with overseas online websites, the PC concluded that the result for "the computer and electronics category was mixed, with some Australian bricks and mortar retailers offering the cheapest prices (some even before accounting for shipping and postage costs)."[6]

IT hardware and software pricing also needs to be considered in the broader context of electronics retailing in Australia, which is a major supplier for these products. Recent changes in the structure of the electronics retailing sector, such as the announcement in February that WOW! Sight & Sound had gone into receivership, the announcement in May that Retravision Southern had been put into administration, and Woolworths' decision to sell the Dick Smith chain in January, are evidence of the pressure that electronics retailers are under. While there are many factors behind these changes, one aspect is that margins for electronics suppliers and retailers are reducing and the capacity to absorb costs is decreasing.

This pressure was also evident in research considered by the PC. The PC compared average gross margins for store-based retailers in Australia compared with overseas markets and concluded that margins were lower for electronics retailers in Australia compared with overseas markets (22% in Australia compared with 23% for the United States, 31% for the United Kingdom / Europe and 35% for the global online average). Electronics retailing was the only retail category in Australia looked at by the PC where average gross margins were lower in Australia than in overseas markets.[7]

[6] Ibid, p. 142.
[7] PC op cit, p. 147

Impact of exchange rate on pricing

The Minister for Broadband, Communications and the Digital Economy's referral letter to the Committee for the IT pricing inquiry questions the link between product prices and the appreciation of the Australia dollar.

The PC examined the relationship between fluctuations in the exchange rate for the Australia dollar and product pricing in its inquiry into the retail sector. The PC's analysis confirms the complex relationship between the exchange rate and product pricing and the difficulty of accommodating the many fluctuations in the spot price in individual product prices including[8]:

- 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).
- 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.

Section Two: Factors influencing pricing in Australia

The terms of reference for the Inquiry seek comment on the factors contributing to price differences in different markets. Product pricing in different markets is affected by a range of factors. These factors include local regulation and standards (for example, warranty requirements under the Australian Consumer Law differ from other markets), wholesale and distribution costs (i.e. freight, transport and storage costs), wage and other labour costs, rent and other occupancy costs, insurance costs and government taxes. These costs vary between markets and can affect suppliers of both physical and digital products depending on the structure of the business and the extent and nature of Australian based operations. Consumer demand and the level of competition also impact on price.

The nature of the Australian market also affects pricing. As a comparatively small market, there is a higher unit cost to produce products with unique specifications compared with larger markets such as the United States because of the lack of scale in production. This is one reason why Australian specific regulation or standards that deviate from international specifications impact on price. Further, the small, geographically disparate nature of the Australian market affects costs such as providing after sales service and product maintenance and servicing. This is particularly the case for services provided in regional areas.

Regulation and compliance costs also impact on product prices. The *Australian Industry Group: Business Regulation* report, released in September 2011, included the results of a survey of over 300 CEOs of Australian based businesses. The survey found that the average business spent close to 4% of annual expenditures on complying with regulation. Seventy per cent of businesses surveyed reported that compliance costs had risen in the past three years and 75% expected compliance costs to rise in the next three years. The main areas of compliance cost increases for business were occupational health and safety (OHS), environmental protection and taxation.[9]

[8] Ibid, pp. 153-5.

[9] Australian Industry Group (2011), *The Australian Industry Group National CEO Survey: Business Regulation*, p. 4.

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, labelling requirements for radiocommunications and telecommunications equipment such as the A-Tick and C-Tick Marks, and 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.

Competition from non-compliant or counterfeit goods offered at discount prices is another source of pressure on legitimate suppliers and retailers.

Importance of IT investment to Australian businesses

The terms of reference to the Inquiry ask for comment on the potential impact of price differences for IT hardware and software products on Australian businesses. The Minister's letter of referral specifically mentions the potential impact on business participation in the digital economy.

Recent Ai Group research shows that investment in IT and technology is important to improving business productivity.[10] The *Business Investment in New Technologies* report, released in January 2012, found that:

- businesses who had invested in new technologies estimated that this investment contributed to 16% of overall productivity gains achieved by the business;
- high performing businesses spent a higher proportion of investment expenditure on new technologies (27.6% compared to 17% and 20% respectively for medium and low performing businesses); and,
- improving productivity was the main reason for investing in new technologies, reported by over 70% of respondents.

The survey found that computer hardware was the most popular category of technology investment with 47% of companies surveyed reporting that this was amongst the top three categories of technology investment in the past three financial years. Just over 19% of companies rated software amongst their top three categories of technology investment (fourth overall) with another 10% rating e-commerce software in their top three. [11]

The *Business Investment in New Technologies* report also confirmed that knowledge and skills are important determinants of business investment decisions in new technologies. The report found that internal knowledge and skills was an important spur to investment in new technologies, and that a lack of knowledge and skills acted as a barrier.

The report also found that only 30% of businesses reported that they had a high to medium degree of information about the practical impacts of high-speed broadband and 45% of businesses rated their readiness to take advantage of a new broadband network as low to non-existent.[12] These results suggest that if Government wishes to lift business participation in the digital economy there should be a greater focus on skills and capacity building.

[10] Technologies in the survey was broadly defined to include computers, software, machinery and equipment, and telecommunications systems.
[11] Australian Industry Group (2012), *National CEO Survey: Business Investment in New Technologies*, p. 8.
[12] Ibid, pp. 20-1.

Section Three: Options for relieving pricing pressures in Australia

Ai Group's view is that product pricing is a matter for the market and general competition and consumer law.

The *Competition and Consumer Act 2010* already contains provisions that regulate unacceptable pricing behaviour, such as the prohibition on resale price maintenance. Additional Government intervention is not warranted.

Governments can relieve pricing pressure by monitoring the cost of doing business in Australia, including the cumulative regulatory burden on business and taxation levels. Governments can act to remove unnecessary regulation, revise regulation that imposes an unnecessary burden, and improve the competitiveness of taxation settings.

Governments can also ensure that Australian regulation harmonises with international approaches where possible to reduce the need for Australian specific product requirements.

Working within international forums to harmonise approaches to regulation and reducing tariff and non-tariff barriers to trade is particularly important. Some of the areas of international activity where Australia can play a positive role in relation to IT goods include:

- Encouraging regional spectrum harmonisation in the 700 MHz band through the adoption of the International Telecommunications Union's Region 3 band plan and the more detailed work undertaken by the Asia-Pacific Telecommunity Wireless Forum (AWF). This would enable economies of scale in equipment production, reducing prices for consumers and suppliers.
- Working with other APEC nations to develop a common approach to risk assessment for electrical goods;
- Addressing non-tariff barriers to trade such as different approaches to conformity assessment procedures (particularly relating to Electromagnetic Compatibility (EMC) and Electromagnetic Interference (EMI)); non-recognition of international standards; and a lack of transparency and openness in domestic standardisation processes.

Governments also have a role in addressing the availability of non-compliant and counterfeit product in the Australian markets, which creates an uneven competitive playing field for compliant products and suppliers. This may encompass a range of strategies including enhanced monitoring and enforcement activities, greater inter-agency cooperation and consumer awareness campaigns.