

**Competition Policy Review Submission – 30 May 2014**  
**Primary Objective = Review of “Resale Price Maintenance” Provisions**  
**Submitted by an independent NSW family retailer**

**Introduction**

As consumers, we all want the very best price for the things we buy. There is no doubt that this policy aim is both noble and supported by Australians, and is generally implemented by regulating out any barriers to competition.

However, we as a society need to consider the longer-term consequences of unchecked competition. Indeed, the Terms of Reference for the Review, whilst clearly espousing a need to reduce barriers to competition, does include caveats such as ensuring measures are in the “public interest”, have “durable outcomes”, include “protections for small business”, and ensure businesses “have incentives to invest and innovate for the future”.

It is my belief that there is a suitable middle-ground, which can see fair and open pricing and competition, without unreasonably hampering our businesses and causing financial distress to small business owners.

**The World Has Moved On**

Australia’s Competition Policies were founded in the 1970s & 80s, at a time when we had things which now seem archaic, such as a pegged currency and high tariff barriers. There were certain systemic, cultural and behavioural barriers to competition within the Australian marketplace, and instruments such as the Trade Practices Act were couched in a way to address that landscape at the time.

It took some pretty hard wording and extreme concepts to bring our economy and our country into the new century.

But in every regard, the world has moved on since then.

I believe that the regulations which were enacted to pull ourselves out of the (figurative) dark ages of the 1970s are now excessive and should be softened to take into account the hardships they impose on honest and honourable small businesses.

**The Flawed Assumption of Perfect Free Markets**

Not only has the Australian economic and business landscape changed significantly since the 70’s, but we have learned that some of our assumptions were misguided.

I did an economics degree in the 1980’s, and one such assumption was that free and open markets will resolve all economic issues. Open market mechanisms were considered a panacea. Whether it’s how many farmers plant wheat, to how many coffee shops a town can sustain, it was believed that, in the end, the market will determine the answer and supply will follow.

Another assumption was the economic principal of “rational consumers”. A consumer will never buy an apple for \$1 when there is an identical apple sitting beside it for 90c.

However, we are now aware that these 2 assumptions have limitations. The passage of time has evidenced that consumers do not always act rationally, and events such as the GFC have proven that unchecked markets do not always work. Both assumptions make sense on paper, and their failure defies logic, but they fail nonetheless, so we can no longer draft legislation that assumes such lofty free-market ideals will always work optimally.

To be clear, the lessons from the GFC (and the checks and balances that have spawned from it) are not confined to the world of finance. Many of the absolute free-market ideas of the 80's are now being questioned in Economics circles, and our Competition Policies need to be adapted to ensure similar extreme assumptions are redressed there.

### **Minimum Selling Price**

My main submission point relates to what the Americans call “minimum selling price”.

It seems somewhat ironic that the most stereotypical symbol of capitalism and free markets, the USA, has a less rigid position on “resale price maintenance” than Australia (given that in most other social contexts Australia has a more soft policy framework, for example, in terms of unemployment benefits, universal healthcare, etc.).

It seems to me to be heavy-handed for a Government to tell the owner of a brand and a product what they can do with it, given we exist in a free-market democracy.

Allow me to reference Nike here (with no consent or involvement of Nike – I have simply chosen them as a well-known brand and company).

Nike unreservedly owns the intellectual property to the brand and trademark of Nike. They design and manufacture Nike shoes, and they import and distribute Nike shoes in Australia (ie. no agents etc.). The government acknowledges this by not intervening in Nike's decisions on who to sell to and how to distribute their own products.

However, the Government strongly enforces that Nike cannot have any control, or even influence, over how much their shoes are sold for.

Why is this? Is it logical, rational, or fair?

Nike's shoes are not a monopoly. There are lots of alternative brands and products, and there is intense competition from Adidas, Puma, Asics, Brooks, and so on.

Nike shoes are not infrastructure, or life's essentials. Frankly, the purchase of a pair of Nike shoes is entirely discretionary.

And as stated, Nike owns “Nike”. It's their product, which they designed, manufactured, marketed, imported, and distributed, at their sole discretion and entirely at their own risk and expense.

So who are we, as a society, to tell Nike they cannot influence what happens to their shoes, and hence their brand image and brand equity, in the marketplace?

Ironically, Nike can close an account if a customer sells Nike shoes in an unbecoming manner (eg. an untidy shop, or in a weekend market) because they are concerned it will tarnish their image. But if a retailer slashes the price of Nike, similarly jeopardising Nike's image as a premium product, they are powerless to do anything.

Nike should have at least some influence over this.

### **The Americans Have it Right**

I would encourage the Review Panel to consider the "resale price maintenance" landscape in other parts of the world, including the USA, to ascertain "world's best practice".

As far as I understand, in the US a wholesaler/manufacturer cannot specifically dictate the resale price of their goods, but they can set a "minimum selling price" to ensure irrational and deleterious competition does not take place, and their retailers can operate in a sustainable market and have sufficient funds to invest and innovate for the future.

What we need, as a society and a government, is a system which balances the aspirations of consumers and businesses. I believe the current Australian regulatory framework is too heavily weighted to the consumer, and we can learn something from the Americans on this point.

### **Real-World Implications of Unfettered Price Competition**

I referenced earlier the demise of the concept of the "rational consumer". Yes, most consumers behave rationally, but all too often we are amazed that someone buys the \$1 apple and not the 90c apple. There is no basis for their behaviour – they just do it.

And the concept of rational behaviour has always been equally applied to both consumers and businesses - both consumers and businesses behave in a purely rational manner.

But in the world of eCommerce, "irrational businesses" abound.

Excessive competition was always checked in the physical world by limits on access to real-estate, finance, goods, and labour. When our competition policies were written, there was no "internet" with its low barriers to entry and truly national reach. Hence the well-founded belief (at the time) that an unrestricted free market would moderate prices and competition.

However the internet has brought these policies, and this whole belief, into question.

I have been selling in bricks-and-mortar stores for 11 years, and online for 8 years, and have seen plenty of "irrational businesses" come and go.

Regularly, we'll see a new online entrant, presumably with the plan that they will become uber-wealthy by listing a range of products on the web at drastically discounted prices.

9 times out of 10 they are broke within 2 years. They seem to have failed to grasp, firstly, that there are many other costs and risks involved in business (and that one needs to clear enough margin to cover these), and secondly, that the incumbents will react. But the havoc they cause in the market (in the meantime) is debilitating.

And what's worse, "there's one born every minute". The waves of such ambitious but ill-informed aspirants are both monotonous and unforgiving.

I should clarify that I am referring, mainly, to the market for homogenous goods. A pair of red Nike Frees, or the latest Kylie Minogue CD. A good which cannot be differentiated in any way other than by pulling the "price lever".

And so

- the market incumbents (retailers), who are numerous and genuinely competing with each-other in a reasonable and long-term manner, are left haemorrhaging money on these products, unable to act in any way due to fears of collusion and/or price fixing, and
- the suppliers are helpless in defending this situation, unable to take any action whatsoever due to the regulatory impost on business

There is no doubt that this is a boon for consumers. All these businesses bashing each-other up is causing incredibly low retail prices.

But the retailers and wholesalers suffer through appalling return on investment, and rapid product life-cycle extinction.

Allow me to spell out the second point.

1. A wholesaler introduces a new product, on which they have spend significant design time and cost.
2. Almost immediately, this product is heavily discounted by one or two "irrational businesses".
3. With the transparency of the internet, other retailers are forced to follow (completely undoing any price advantage the first-mover may have hoped for), and the new market-price for this product is set at a level which allows an insufficient return.
4. Retailers then delist this product, since it cannot make a suitable return, thus prematurely ending the life of the product and causing the wholesaler to have to quit their stock-holding at a loss, and spend yet more money and time inventing a revised version.
5. Refer back to step 1!

These seem to be poorly publicised elements to competition policy, and certainly undermine business's "incentives to invest and innovate for the future"<sup>1</sup>. In turn, this impacts "long-term consumer benefits".

This continuously debilitating spiral of price-only competition would appear to be undermining the review panel's aim to embed "durable outcomes" in the competition provisions.

Excessive and rapid price competition is leading to reduced product life-cycles, hence producers are less and less incentivised to innovate and invest, hence the consumer wins in the short term, but loses in the long term.

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<sup>1</sup> <http://competitionpolicyreview.gov.au/terms-of-reference/> - "Overview"

## **Real World Examples**

1. I have a friend who used to operate one of Australia's larger technology hardware retail websites. It got to the stage where competition was so intense, and margins so low, that he simply couldn't keep it going. He was a smart operator who had squeezed every last cent out of operating overheads, and his buying power was as good as anyone's, but new entrants just kept coming, thinking they could win the game by selling at cost+1%, and the landscape was simply littered with bankrupt retailers acting like lemmings. My friend closed the business completely, and moved to the USA where he now runs a successful and sustainable website.
2. As I type this submission, literally, I have been communicating my decision to my staff to quit a major brand from my stores and website. This is an important brand and a major player in its niche, and now customers in my region as well as online no longer have access to it from me. The reason is simple – a small number of retailers, with no better overhead structure or buying power than me (and in many cases, worse) are simply smashing the prices to try to get market share. The supplier is frustrated by this but is powerless to act. At a “fully absorbed cost” level (a concept I don't imagine these competitors even understand) we are all losing money on these products, and thus I have dropped them. This has led to less choice for my consumers (and a complete loss of this entire range from the region in which I operate my stores), less money for me to invest in innovation, less ability for me to service my market, and less ability for me to provide valuable information to my customers. This is a deleterious move both for the market and for the consumer.

## **Issues Paper Over-simplification**

Page 7 of the issues paper says “The benefits of competitive markets include lower resource costs and overall prices, better services and more choice for consumers and businesses, stronger discipline on businesses to keep costs down, faster innovation and deployment of new technology, and better information allowing more informed consumer choices.”

Yes, prices are forced down, but due to irrational business behaviour and an inability of the market participants to protect their position;

1. Services are worse, since there is no margin to actually fund increased services such as advice and delivery
2. Choice is reduced because there is no margin to fund R&D or to take risks
3. Ditto, innovation and deployment of new technology is stymied as there are no meaningful profits to reinvest in the activity
4. Information is lessened, as there is no margin to pay for the time that is required to pad out product information pages, or pay for information distribution.

Perhaps what the panel meant to say was “The benefits of rational competitive markets...”?

We need to make a reasonable and sustainable profit in a market filled with sane and educated businesses in order for these “benefits” to actually occur. Motherhood statements like the page 7 quote sound great in a lecture theatre or election campaign, but are definitely flawed in the real world in 2014, where businesses are viciously competitive anyway.

## **Fraud on the Minority**

I learnt at university of a concept of corporate law called “fraud on the minority”.

In brief, it says that a majority of shareholders of a company cannot pass a resolution which, in effect, transfers the assets or entitlements of a minority of the shareholders to themselves.

It strikes me that the current consumer-centric competition laws are, in effect, a fraud on the minority (conceptually, not legally).

The majority of consumers (the 20 million voters, through their elected members of parliament) have implemented laws which force a minority (say a couple of dozen small businesses competing in a particular market) to stand in a ring together and fight to the death, without the ability to act. The majority are, in effect, forcing a transfer of assets from the minority to themselves.

I understand the limitations of this analogy, but am simply trying to draw the connection that the Government feels morally obliged to stand up for the minority, and has set a number of precedents in doing so, and any revision of the competition landscape should allow for equal protection of consumers and businesses.

In terms of “public interest”, businesses are members of the “public” too.

## **Freedom of Speech**

Whilst I am drawing broad analogies of social principles, it also strikes me that the current laws are, again morally not legally, impinging on the rights of business owners to freedom of speech.

Even if (say) Nike cannot tell a customer what to charge for their goods, surely they have the fundamental right to speak their mind about the negative effect it is having on their product life-cycle and brand image. One would have thought that the laws currently in place preventing Nike from even speaking to a customer about price could be revisited by the Review Panel.

## **Are Our Regulatory Aims Equitable and Fair?**

A small business’s profit is to a worker’s wage. I use what profit I can eke from my business to pay my rent and my children’s school fees, just as the reader’s wage does the same for him. However our policy framework protects “stronger real wage growth” (quoting the review guidelines) but not a business’s profit. Is this discriminatory? I’m not suggesting that my attempts to make a profit are more important than an employee’s attempts to grow their real wages, but why is it less important? Why is my attempt to increase my hard-earned profit evil, and yet an employee’s attempt to increase his wage noble?

Our policy framework supports “higher standards of living” for consumers, but really this is code for “lower prices for consumers” and therefore, in effect, lower standards of living for business owners.

The challenge for the Review Panel is to implement a framework which can work for both consumers and businesses – which can push down prices and open up competition, but allow business people to eke out an existence and operate under fundamentally fair rules.

### **Conclusion**

1. The world is not the same now as it was when the TPA was enacted in the 1970s, and our pro-consumer laws need not be so extreme now that the market is so much more sophisticated and open.
2. Since the 1970s, we have learnt that open markets are not perfect, and participants do not always act rationally, and we cannot draft 2014 laws which assume these 2 assumptions blindly apply, as we did in 1970.
3. A brand owner should have the right to have some influence over the market activity of their own brand, including the price at which it is sold. Whilst they should never be allowed to dictate a price, they should be permitted to take some sort of action (eg. withhold supply to a retailer whom they deem to be not acting in their best interests) since it is their brand.
4. The American system of “minimum selling price” would seem to be a more evenly-weighted set of rules than the ones we currently have in place in Australia.
5. eCommerce has seen the emergence of a truly national market, and hence the irrational behaviour of a small number of participants in one part of the country can have deep-reaching and deleterious effects on the entire market.
6. Product life-cycles are limited by rapid price competition, and hence innovation is stymied and choice is reduced in the long term.
7. Excessive price competition, particularly on the internet, actually leads to reduced choice, less service, lower innovation, and abbreviated information.
8. Lofty lecture-theatre statements about the comprehensive benefits of competition, especially price competition, are frequently not borne out in the real world, and real-world learnings and activities should be factored into any reviewed competition regulations.
9. This country is a democracy, and itself a free market, and these fundamental principles seem to have been overlooked in overly limiting a business’s ability to act in its own best interests, which conjures up questions about Australia’s commitments to such basic principles as “freedoms of speech”, “fraud on the minority”, and “equity”.

I would encourage the Review Panel to give equal weight to the protection of small business people and consumers, and to ensure that resultant regulations are neither one-sided (ie. enforcing the protection of consumers at the expense of business) nor based on the flawed concept that business people will behave rationally and that completely free markets are a panacea.