



ECONOMIC STRUCTURE AND PERFORMANCE OF THE AUSTRALIAN RETAIL INDUSTRY

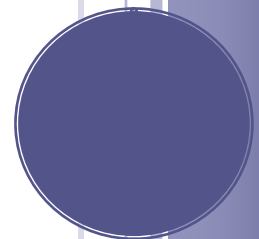
Productivity Commission Submission

A Submission to the Productivity Commission by the Boating Industries Alliance Australia in response to the Issues Paper of March 2011.

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BACKGROUND

The recreational and light commercial marine industry is an important contributor to the social, economic and environmental wellbeing of Australians. The industry makes these contributions in urban and regional Australia by creating employment, creating supply chain demand, enabling important lifestyle options for communities, developing important recreational marine infrastructure and increasing environmental awareness and management of marine environments.

Demand from the Australian community for recreational marine experiences has been trending up for many years. This is evident in growth in the size and scope of the recreational fleet in each State of Australia. As a result, it has fostered the development of the recreational and light commercial marine industry in the nation. This industry encompasses the following sectors:

- Manufacturers and repairers of boats, power plants and related products;
- Dealers, Brokers, Retailers and Syndicators;
- Marina operators and developers;
- Marine infrastructure providers;
- Marine based tourism operators, for example charter operators;
- Boat clubs, marine based sporting organizations such as sailing;
- Marine training, licensing and education organizations;
- Event organizers;
- Insurers, financiers, legal and other professional service providers.

The industry is estimated to generate \$13.3 billion per annum from its operations and employ 74,000 employees directly and indirectly in the industry.

Historically the Australian recreational and light commercial marine industry has serviced local and overseas markets. It has a long and proud reputation for quality, safety, excellent service to its customers as well as a leader in environmental stewardship.

The onset of the Global Financial Crisis in late 2008 however has changed the way the industry has operated within this country. Within a relatively short period of time, high population markets in North America and Europe have viewed the Australian recreational marine market as a buoyant option to increase their sales in poorly performing domestic markets. As a result, the level and diversity of grey and parallel imports into Australia has experienced explosive levels of growth to the direct detriment of the Australian industry, consumer and environment.

This submission summarizes the impacts of the dramatic increase in imported product to the Australian market – much of which comes in via unauthorized channels and the direct negative consequences that are evident as a result of the changed global marketplace for recreational and light commercial marine products. These issues encompass:

1. Negative consumer outcomes including the sale of non-compliant and defective products, fostering the development of unauthorized channels that do not carry product liability protection, the absence of warranty, spare parts inventory and after sales support; and
2. Direct industry development impact as a result of restrictive franchise code limitations on authorized channels in Australia, much higher (but appropriate) operational costs due to compliance with Australian standards and regulations, job losses, business failures and loss of important intellectual property and private investment particularly in regional Australia.

THE AUSTRALIAN RECREATIONAL MARINE INDUSTRY

The Australian Recreational Marine Industry plays a significant role in Australia's tourism and recreation. Currently, recreational boaters account for 10.3% of Australia's overnight stays and this percentage has risen steadily in the last decade from the trough of 2000.

Recreational boaters generally have average to higher incomes and are in the family life stages. They also have a strong association with caravan parks in terms of where they stay when on holidays with their boat.

The Recreational Boating Industry has a 4.3% share of Australia's total day trip market. In both the overnight and day trip markets, recreational boating is one of the top 10 activities people undertake when on holiday or on a day trip. This is higher than comparable tourism activities such as going to wineries and festivals/fairs.

In total, the Recreational Boating Industry generated \$5.522 billion (05/06) in expenditure on holidays and day trips in Australia, therefore making it a significant contributor to the tourism market. The sector accounts for 7.4% of the total tourism spending (\$75 billion).

The peak national industry Association for the recreational and light commercial marine industry in Australia is the Boating Industries Alliance Australia (BIAA).

Size and Economic Contribution of the Industry

The industry generates \$13.370 billion in spending attributable to operations. This includes industry turnover and also net additional tourism spending. In total, the Recreational Boating Industry generates direct industry revenues of \$7.8 billion nationally, including \$1.268 billion in export sales.

The Industry contributes \$4.066 billion to the economy (GDP) and supports just over 74,196 jobs both directly and indirectly. Twenty eight thousand people are directly employed in the sector. In terms of economic size, the Recreational Boating Industry is nearly triple the size of the Australian Ski Resorts.

In Australia, the Industry's direct employment contribution is bigger than Life and Insurance funds and employs more people than the forestry and logging industries. It is about the same size as coal mining and water supply.

The recreational industry is larger than the Caravan Industry. The Caravan, Recreational Vehicle and Accommodation Industry of Australia, the peak caravan park association in Australia, estimates that the caravan park sector directly employs 17,000 people and generates over \$1.7 billion annually. The recreational boating industry also contributes significantly more than the cruise shipping industry to Australia. Cruise shipping generated \$252.6 million in direct spending. In terms of tourism spending, the Industry is about double the size of the back packing industry.

Industry Development and Impact

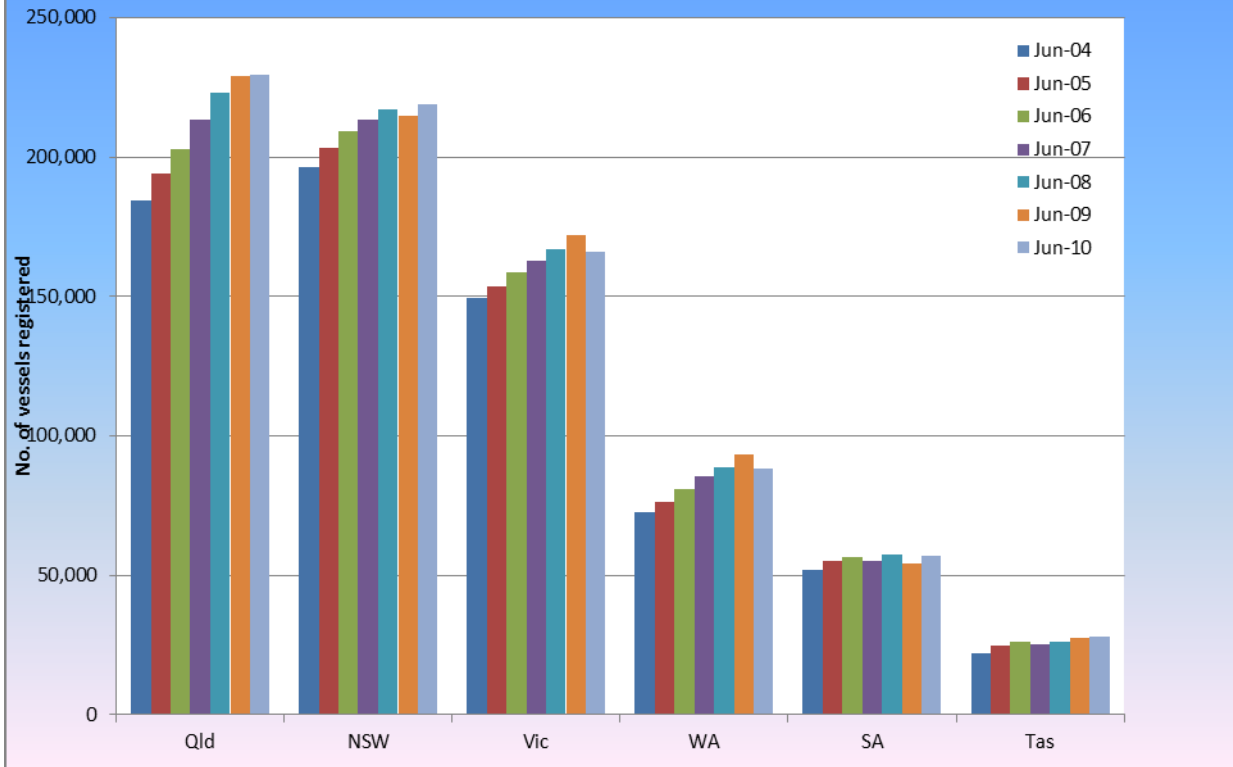
Increasing the consumer participation in the Industry will have a significant economic benefit to Australia. If the Industry increases in size by 5%, this will add \$276.1 million in tourism spending, \$392.4 million to Industry revenues and provide \$203 million in economic contribution to Australia. It would also support an additional 3,710 full time equivalent jobs.

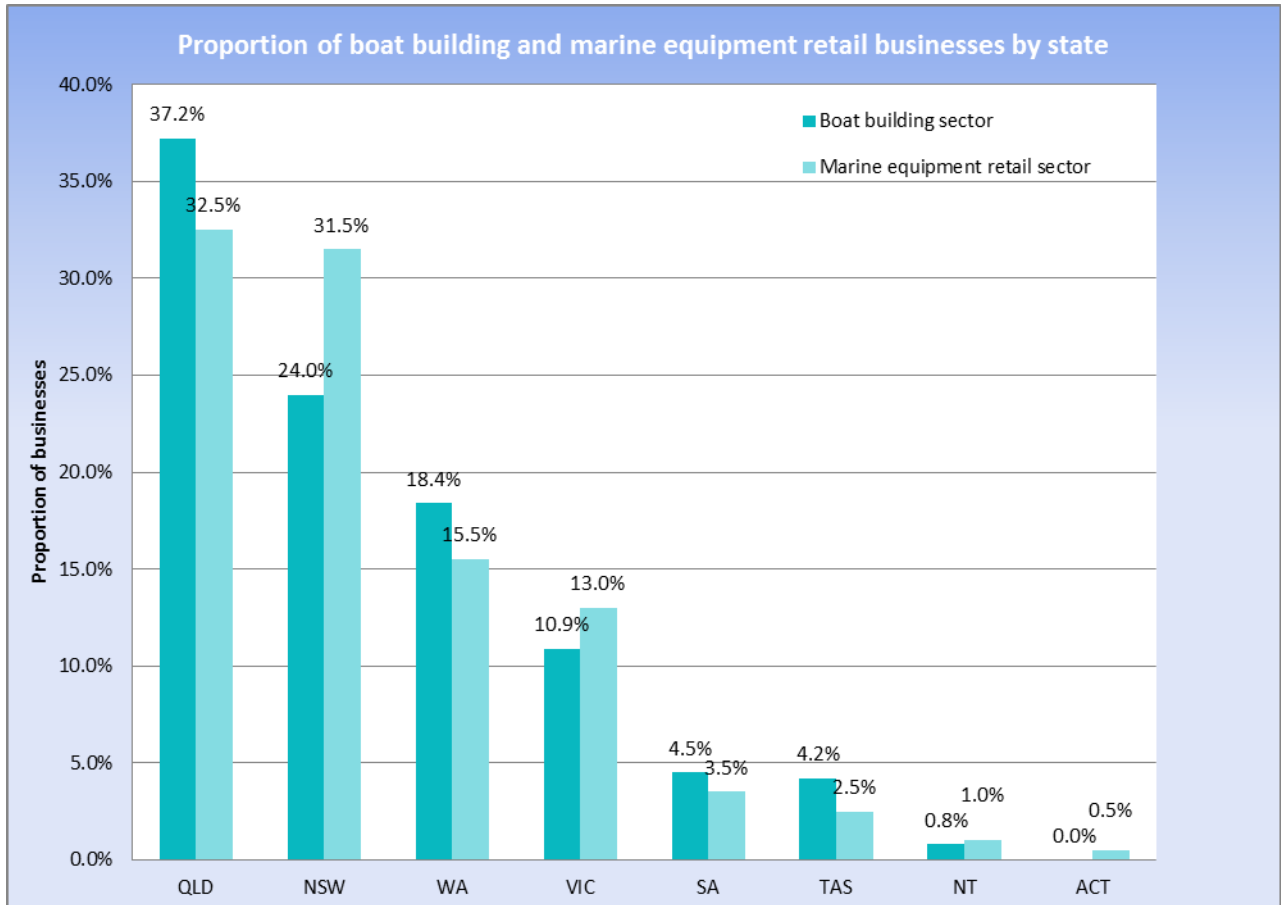
The analysis shows that if 5% of recreational boaters' trips can be transferred to Australian holidays then this would save \$61.3 million in tourism spending going overseas.

The Australian Recreational Fleet and Industry

The Australian recreational fleet by State (excluding NT where vessels are not required to be registered) and State distribution of manufacturers and retailers is as follows:

State trends in the number of registered Recreational Marine Vessels
June 2004 to June 2010





GREY AND PARALLEL IMPORTS

Few commercial events in recent years have generated as much controversy within the Australian recreational and light commercial marine industry as parallel importation. Parallel trading has emerged as one of the major issues of ongoing discussion and concern relating to international trade and practice within the industry. It contains a variety of complex and pragmatic issues, including economic, legal, marketing and consumer protection matters.

On the one hand, it is desirable to shield the public from possible confusion or deception regarding the origin of a branded good. Advocates in favour of parallel importing argue that placing restrictions on parallel imports creates artificial barriers to free trade. Therefore, there is no consensus about the current policy relating to parallel imports within the ranks of Government agencies or elected Government representatives.

Every year millions of dollars worth of products in the world market are imported outside (in parallel to) manufacturers' authorised distribution channels. The term parallel imports is used to emphasise the fact that unauthorised products are *imported* across country borders and a *parallel* channel is created to rival authorised ones. Since the mid-1980s there has been a growing interest in local markets in so-called "grey market", or what is referred to, in this paper, as parallel imports. According to the academic literature,

imported parallel goods are products that entered a market in ways not intended by the original manufacturer. In fact, the term “parallel import” is a loosely used expression intended to explain any goods sold outside “normal”, authorised distribution channels. It is defined as, “*Taking advantage of the lower price, some enterprising middleman buys stocks in the cheaper foreign country and imports them into the dearer, domestic country. Hence, the imports may be described as being imported in “parallel” to the authorised distribution network.*”¹

It is important to note that under current Australian law parallel imports have, by definition, been made lawfully. Therefore, the actual making of the imported articles did not infringe manufacturer patents or other protections. The goods imported in parallel are not “pirate or illegal” copies. In effect, a parallel import channel exists alongside the authorised one set up by a manufacturer resulting in intra-brand competition. This fact creates many challenges for authorised industry participants singularly and collectively as well as placing pressures on the consumer perception of the Australian Industry and their perceptions of what protection that affords them.

This paper seeks to identify and discuss key issues as well as develop a roadmap to ensure the Australian industry and their customers are appropriately protected from the negative consequences of parallel imported products.

PARALLEL IMPORTING INTO AUSTRALIA

Parallel imports affect a wide range of industries and are not unique to the recreational marine industry. They significantly impact a wide range of goods including traditional luxury and brand- name consumer products (wines, cameras, watches, books, etc.) to industrial and commercial products.

Another trend relating to parallel imports, is that this has evolved from basically a U.S. problem in the 1980’s into a world -wide phenomenon in the 90’s. When the U.S. dollar was strong, during the 1981-1986 period, the number of cars purchased in Europe by U.S. tourists grew 2,000%. In 1986 the total value of products distributed through unauthorised channels in the U.S. reached a peak of \$10 billion. This direction was reversed in subsequent years as other parts of the world, especially Asia and Europe, experienced rapid appreciation in their currencies and a corresponding surge of parallel imports. A 1991 survey of U. S. exporters to Asia showed that 41% of 141 respondents reported having problems with parallel imports in the past five years². In an increasingly integrated world, the annual growth rate of parallel imports has been estimated to be 22%, and this is expected to rise as new trade agreements, like NAFTA and GATT, further lower trade barriers across nations.

There are essentially two reasons why parallel imports occur in international markets. The parallel import or “grey market” exists because foreign manufacturers practice price discrimination among countries and grey market sellers arbitrage these price differences. Second, parallel importers are more efficient than authorised sellers because parallel imports compete with the goods of authorised sellers, in turn leading to lower prices that are beneficial to consumers.

¹ Rothnie, A.W. (1993) *Parallel Imports*, London: Sweet & Maxwell

² Palia, P.A. and Keown, F. C. (1991) Combating Parallel Importing: Views of US exporters to the Asia-Pacific region, *International Marketing Review*, 8, (1), 47-56.

Those favouring parallel imports argue that international price discrimination restrict competition to the disadvantage of consumers in countries having higher prices. They say that parallel imports foster competition and efficiency, thus benefiting consumers in importing countries. Some researchers argue that, while it is clear that active parallel imports cannot exist without price differentials between countries, the source of these differentials is not quite so apparent. Depending on the type of goods involved (boat, motor or accessories) and the character of the market for the product, price differentials can be the result of a variety of factors, ranging from honest enterprise, such as a diverter who takes advantage of favourable foreign currency exchange rates and engages in a sort of product arbitrage, to a manufacturer who attempts to discriminate by price in different (usually foreign) markets.

A more questionable strategy in regard to parallel imports, is free riding or the practice of selling goods identical to those sold by full-service dealers without incurring the expenses of promoting and servicing the product. Such free riding falls into two categories:

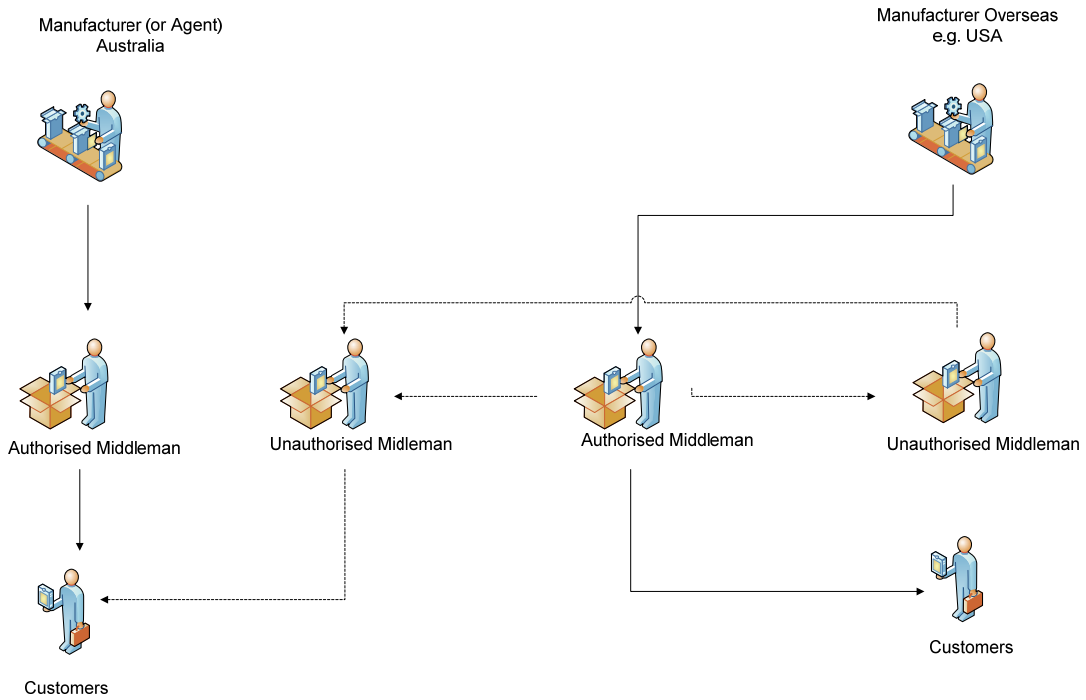
- a) advertising free riding; and
- b) point-of-sale free riding.

An advertising free rider takes advantage of the advertising and marketing efforts of authorised sellers, reaping consumer recognition and other benefits that flow from this advertising without incurring the attendant expense.

The second but distinct form of free riding, point-of-sale free riding refers to the failure of an importer to provide various ancillary services that consumer's desire. Such services range from product instruction, to the maintenance of an inventory of spare and auxiliary parts, or the provision of warranty or repair services. Another type of free rider may also sell trademarked goods without taking sufficient safeguards to ensure product integrity. For example, by compromising on product compliance with Australian standards and regulations, packing, transportation, storage, or inspection costs in order to keep the price of goods lower.

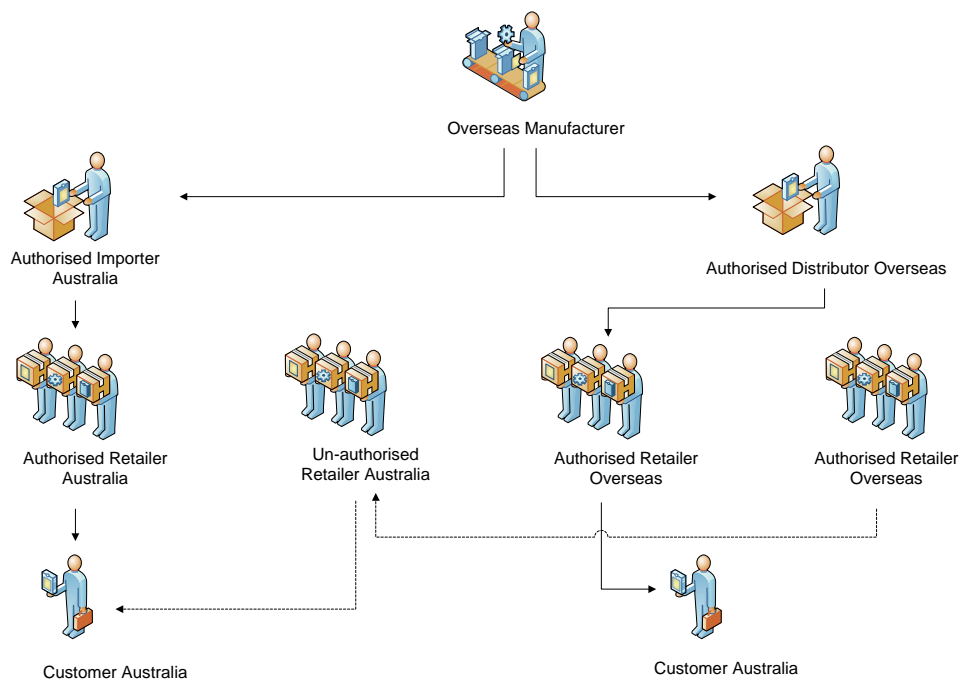
Therefore, in regard of the process of parallel imports, there is no end to the imaginative ways used to bring parallel imports to market. Four methods, however, represent the bulk of market imports and are focus of much of the economic and legal attention. First, are those products made overseas by for example American firms (see Figure 1). These foreign units may be subsidiaries, joint venture companies, or some other entity which have a commonality of interests with the American company. This foreign affiliate may sell to nearby authorised distributors, for example, a Australian firm. Somewhere in the authorised channel, however, distribution control is lost and the product gets into an unauthorised channel. Here it competes with (an apparently) identical domestically (authorized) imported products.

Figure 1. Case 1 Parallel Imports



The second method (depicted by Figure 2) of parallel importing is when a foreign manufacturer licenses a company to be the exclusive importer of a product bearing a foreign name or trademark.

Figure 2: Second Case of Parallel Imports Process



The company that registers the foreigner's name becomes the legal trademark owner in their own market and agrees to pay royalties. Cases exist where a third party trader purchases this same product which is intended for a third market. They then ship the product to a market it was never intended as a parallel import.

In addition to these scenarios, there are many other versions or permutations that all result in product entering into the Australian market as a parallel import. These also include mail orders or orders placed via the web and imported directly to Australian consumers. Under these scenarios, anyone with a credit card and access to an internet connected computer can order products directly from manufacturers, authorized distributors or other parties outside of Australian authorized channels.

As can be seen, this is a very complex environment and given the international sensitivities associated with free trade agreements, a very difficult issue to control without a strong will of the domestic government particularly through enforcement programs at the point of entry into Australia.

THE EFFECTS OF PARALLEL CHANNELS

There are a number of effects of all of this parallel importing activity. Here, the predicaments and opportunities created by these parallel distribution channels are discussed in more detail.

First, consumers may be prejudiced against buying products which have been parallel imported because sometimes they cannot be properly serviced or maintained. They also may be worried that the so-called technical requirements for certain products may not met by grey and parallel importers. Under a number of existing franchise agreements with manufacturers, franchisees are specifically prohibited from providing service, parts or support for unauthorized products imported into Australia, for example, engines, jet-skis and the like.

It needs to be made clear that parallel imports are not counterfeits but genuine products that are often sold at a lower price to consumers than these distributed by regular channels. However, these may not necessarily have a lower profit margin because they can free ride on the promotional efforts of authorised dealers. Consequently parallel imports may undermine authorised dealers' selling efforts for example, by discouraging their investment in a sales-force training or shelf-space and showroom facilities.

In other words, parallel imports may have financial consequences for licensed distributors, if they do not derive sufficient revenue from the sale of these branded goods. In such instances they may not be able to continue with their advertising and promotional efforts. Parallel importing of trademarked goods may also create confusion for consumers. However, some industry participants (typically unauthorized distributors) argue that because parallel importers sell genuine trademarked goods there is no possibility of confusion about the origin or source of the goods. However, under the new consumer laws the importers of these products are deemed to be the manufacturer. Therefore, when the Australian Builders Plate is attached to the vessel (say, a Kawasaki jet-ski), the name of the manufacturer on the Builders Plate will be the name of the importer – not the manufacturer of the article – in this case Kawasaki.

Although, modern international trademark law does not support this view, involving an unauthorized channel or outlet increases the likelihood of consumer confusion about product source and quality. The “source function” of a trademark encompasses more than the geographic origin of goods. As a result of modern marketing and distribution techniques, consumers perceive a “genuine” article to be those from the wholesaler, retailer or servicing company they have been able to rely on in the past. The authorised distributor is in effect the “sponsor” of the trademarked good, providing many ancillary services. Consumer confusion is possible if the parallel importer does not disclose that they are not the authorized distributors or they do not offer the same warranty protection or services, which the consumer has come to expect. The “quality function” of the trademark does not replace the “source function” but stands alongside it as a “guarantee” of consistent quality. In the grey market, genuine trademarked goods possess identical product quality when shipped from the factory.

Product quality, however, is not simply measured at the factory; it is also determined at the time of retail sale. Many trademark owners thus invest in their product by careful shipping, storage, inventory control, and quality management. This investment is a natural adjunct of their desire to build and protect the reputation of their product and service offerings within their local markets. In contrast, grey marketers may unknowingly or knowingly sell inferior products because they provide less quality control and have less incentive to make these expenditures. Compliance is a common concern with this type of product as it invariably has been manufactured for a target market other than Australia.

Inferior products however, confuse and deceive consumers and may negatively impact genuine products and their image. Manufacturer-distributor relations can also be strained by the appearance of parallel imports. Distributors feel frustrated by having them in their markets and look to the manufacturer to reduce or eliminate this unforeseen competition. Manufacturer’s profits also may decrease because of parallel imports. Sometimes they may be forced to buy back old stock from authorised distributors because parallel importers create an oversupply in the market.

A further and significant context is that of an industry development perspective. By international standards, the Australian recreational and light commercial industry is not large, particularly in countries with significantly larger populations than Australia. The Australian industry (across a range of sectors) is still developing. This is particularly the case in regional centres of Australia. Where parallel imported product is dumped into those markets it not only reduces the growth potential of authorized industry participants but also potentially damages the image of authorized operators when the consumer has problems with parallel imported products.

A further international trade issue is that some manufacturers with parallel imported products use parallel imports to penetrate developing foreign markets. There is some evidence to suggest that some United States’ manufacturers recognised that parallel channels could be used to increase overall foreign sales and market share. Furthermore, when a final decision on an exclusive distributorship was pending, a parallel channel gives the manufacturer an opportunity to evaluate one distributor against another.

Parallel channels may help overcome a weak distributor's performance at no additional costs to the manufacturer. Sales that go through parallel channels may expand a manufacturer's market coverage if the authorised distributor lacks the capacity for covering the whole market. This situation may be very common in developing markets where distributors often lack the financial and marketing resources to effectively push and pull products through the distribution chain.

However, by far the most serious issue that arises is when a manufacturer uses parallel importing to circumvent trade restrictions or obstacles. In other words non-tariff trade barriers exist in the form of quotas or import licences, the authorised importer has limited sales opportunities. The parallel exporter, who sells to a different importer under separate quota or license, provides the manufacturer with additional sales.

All of these scenarios are detrimental to industry participants that have invested heavily in establishing legitimate distribution channels for the Australian market.

FUTURE TRENDS IN PARALLEL IMPORTING

The trend towards the globalisation of markets, which is being facilitated by the development of a global communication system, envisages the end to domestic territoriality because of global competition. Because of the speed of new technologies and communication developments, parallel importations without measures to protect consumers and businesses that have invested in legitimate channels, the negative consequences of parallel importing are likely to become worse.

However in recently published materials the ACCC view of parallel imports suggest the opposite. Their view is the impacts of globalisation on parallel importation are two-fold. First, as trade barriers between nations decrease, it will become more difficult to implement price discrimination policies based on country boundaries. Implicitly, parallel traders are therefore likely to gradually disappear, as there will be fewer opportunities for arbitrage. The issue of parallel importation may therefore become less significant as globalisation continues.

Secondly, traditionally, under international law, nations have asserted sovereignty based upon the territory that they legally control. Advances in electronic communications, including the Internet, however, have begun to change this. This development suggests that, rather than sovereignty based on territory, sovereignty will be based on information flows or economic spheres of influence will become the norm in cyberspace.

This hypothesised shift will however, require a re-evaluation of present legal frameworks that apply to authorized distribution channels where the industry argues places authorized channel participants at a competitive disadvantage.

Nevertheless, when the world economy becomes far more globally integrated, which is likely in a digitally based economy, it becomes necessary to harmonise the different transactional rules between nations. This means policy co-ordination among different governments will be a critical step in achieving this. In this regard, the Association needs to guide the new legislative frameworks to ensure that the Australian marine industry is able to grow and develop within a fair competitive environment.

OPTIONS TO PROTECT THE INTERESTS OF AUSTRALIAN INDUSTRY

The following approaches have been identified as options to consider as a means of ensuring the interest of the marine industry are protected. This list is not intended to be exhaustive but aims to stimulate discussion and debate on this very complex issue. Similarly, each of these approaches are not intended to be stand-alone solutions to these complex set of issues for the Australian Marine Industry. In fact it is expected that a multi-pronged approach will be necessary to appropriately address these issues.

1. Australian Product Standards

Many areas of the Australian marine market remain largely unregulated. For example in the motor vehicle industry (which has been the subject of extensive assistance and protection by many Australian Governments) the existence of the Australian Design Rule (ADR) for vehicles means that any imported product must comply with that rule before being eligible for legal use on Australian public roads.

The development of a like standard for Australian recreational craft (in addition to existing build standards such as AS1770) would significantly assist in ensuring that imported product is of an appropriate standard and quality before being eligible to be imported into Australia.

The development of such a standard for the Australian market will require support and assistance from key industry stakeholders to ensure that it achieves its intended application to Australian markets.

2. Australian Franchise Code

Many Australian Franchise Agreements are being used as a defacto means of placing trade limitations on Australian authorized distribution channels. One key issue with this approach is that manufacturers are not taking a consistent approach to the application of franchise agreements. In addition, manufacturers also take differing approaches to warranty periods and other conditions depending on the channel taken for product imported into Australia.

Again, this topic is a complex issue however the following courses of action may be worth further investigation and assessment:

- a) Develop an industry endorsed standard franchise framework agreement that may be used with Franchisors to negotiate arrangements that foster the Australian industry. This approach seeks to develop a contractual solution to the issue rather than a legislative solution;
- b) Make further amendments to the Australian Franchise Code to protect small and medium size businesses that are required to enter into agreements with large international corporate organizations where the balance of power is heavily weighted to the international corporate entity.

3. Consumer and Market Measures

Many other industry operators develop extensive consumer education programs and industry endorsed standards as a means of limiting the profile of unauthorized channels. However for the consumer where price is the dominant factor, such programs are likely to have little relevance. If the consumer perceives a bargain is in the offering, little regard for after sales support is made at the time of purchase.

Notwithstanding this, there is a significant part of the market that places high regard to membership of the industry associations. With this comes a (often strong) perception that it carries with it many consumer protection measures, high standards and options for recourse when problems arise.

Options worth further consideration may include:

- a) Industry accreditation or certification programs;
- b) Compliance programs for Association members with adjunct consumer “buy with confidence” marketing campaigns. Possible vehicles for such campaigns could include boat shows, the proposed Discover Boating program, State Association web sites and the Boats on Sale web site.

CONCLUSIONS

The Australian recreational marine industry is significant to Australian communities – not only economically but also socially and environmentally. The economic, social and environmental benefits to the community flow as a direct result of the growth and development of the industry within the country.

The proliferation of grey and parallel imports into Australia particularly on the back of a strong exchange rate is exacerbating the issue. Most significantly however is the fact that much of the product being imported has been manufactured for overseas markets. This often means that compliance with Australian standards and regulation is absent and presently not being enforced at the point of entry into the country.

The Australian industry and its participants are being negatively impacted. The Australian consumer is also being disadvantaged.

Accordingly we urge the Productivity Commission to make recommendations to support:

1. Implementation of compliance programs;
2. Implementation of consumer education and awareness programs;
3. Outline a regulatory reform agenda to support Australian industry.

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