



COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON INFRASTRUCTURE AND
COMMUNICATIONS

Information technology pricing

(Public)

FRIDAY, 22 MARCH 2013

CANBERRA

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON INFRASTRUCTURE AND COMMUNICATIONS

Friday, 22 March 2013

Members in attendance: Mr Champion, Mr Husic, Mr Stephen Jones, Mr Neville, Mr Symon.

Terms of Reference for the Inquiry:

To inquire into and report on:

- (a) Whether a difference in prices exists between IT hardware and software products, including computer games and consoles, e-books and music and videos sold in Australia over the internet or in retail outlets as compared to markets in the US, UK and economies in the Asia-Pacific
- (b) What those differences are
- (c) Why those differences exist
- (d) What the impacts of these differences might be on Australian businesses, governments and households
- (e) What actions might be taken to help address any differences that operate to the disadvantage of Australian consumers

WITNESSES

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KING, Mr Anthony, Vice President, Apple Inc.**Committee met at 09:29**

CHAIR (Mr Champion): I declare open this public hearing of the House of Representatives Standing Committee on Infrastructure and Communications. The committee commenced an inquiry into IT pricing in Australia on 24 May 2012. Since that time 122 submissions, including seven supplementary submissions, have been received and the committee has heard from many interested parties both in public and in private. The committee welcomes the attendance of representatives of Apple, Adobe and Microsoft here today and welcomes anybody who is watching or listening to the broadcast. Before asking the witnesses to introduce themselves I remind members of the media who may be present or listening to the web of the need to fairly and accurately report the proceedings of the committee.

Welcome. Although the committee does not require you to give evidence under oath, I should advise you that this hearing is a legal proceeding of the parliament and therefore has the same standing as proceedings of the House. We have received a written submission to this inquiry from you—submission 62—and it was accepted as a confidential submission and later, with Apple's permission, made public. Do you wish to present any additional submissions or make an opening statement?

Mr King: Yes, I do.

CHAIR: Proceed.

Mr King: Thank you. Good morning chair and members of the committee. I am here today to respond to the committee's request to address stated concerns regarding Apple's hardware and software pricing and to help the committee better understand why there may be differences in the prices of Apple products sold in Australia when compared with other markets, including the United States.

Apple is proud to do business in Australia. Our goal is to provide our customers with the world's best products and services coupled with an unrivalled user experience. We sold our first computer here over 30 years ago and today have an enthusiastic community of customers and software developers across the country. We operate 18 Apple retail stores nationwide and, combined with our corporate office in Sydney, employ over 2,600 people. Apple's main corporate activities in Australia include the sale and distribution of our products through our channel partners located in over 6,000 sites across the country, our Apple retail stores, the Apple online store and the iTunes store. In addition there are over 160,000 app developers in Australia who are enjoying success around the world by selling their applications on the App Store. Many of these are individuals and small companies now competing head-to-head with the biggest names in the global software industry. We are delighted to have played a role in creating this new app economy.

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

When comparing prices it is important to remember that the US retail prices do not include sales tax. Here in Australia, of course, a price includes a 10 per cent GST. That fact alone is responsible for a great deal of confusion and has resulted in some inaccurate conclusions regarding our pricing. When pricing Apple products for the Apple online store and at Apple retail stores in Australia, price considerations must go well beyond simply looking up a currency exchange rate. For example, Apple must consider differences between countries in product costs, freight charges, local sales taxes, levies, import duties, channel economics, competition and local laws regarding advertised prices. This detailed financial analysis results in product pricing that may be either slightly lower or slightly higher than US pricing for the same product. As you can imagine, it would be unduly complex to administer and confusing to our customers to attempt to adjust every product price with the daily fluctuations in the currency exchange rates. Therefore, Apple re-evaluates and adjusts local prices to be in line with the US prices, among others, at the time of new product introductions.

However, primarily because of currency fluctuations on any given day, Apple product pricing may appear higher or lower when compared to prices in the US market. For example, based on exchange rates from last week, all of Apple's bestselling MacBooks and iMacs in Australia were priced within two to seven per cent of US prices. A few days prior, some of the products were equally priced to the US, including the iPad with retina display. Looking at our entire range of Mac, iPhone, iPad and iPod products, the average differential to the US pricing last

week was just five per cent. The average differential for our Apple software product range was minus one per cent. This, of course, takes into consideration GST. None of this is to suggest that all of Apple's product offerings are exactly equal in price in Australia as in the United States. It is just that at any given time some Apple products may appear to be priced slightly cheaper or more expensive than comparable US retail prices.

I would also like to clear up some common misconceptions with regard to digital content pricing. As we have explained in person to the committee as well as in our written submission dated 6 July 2012, the retail pricing model for music, movies and TV shows made available on the iTunes store is different from the pricing model for Apple branded products. The iTunes store is a digital media store. Apple must pay the rights holders of the digital content—the record labels, movie studios and TV networks—to distribute content in each of the territories in which the iTunes store exists. The pricing of this digital content is based on the wholesale prices which are set through negotiated contracts with the record labels, movie studios and TV networks. In Australia they have often set a higher wholesale price than the price of similar content in the United States. Nevertheless, our own market analysis suggests that the price of digital content sold on the iTunes store in Australia is comparable to other Australian physical and other online stores. This would indicate that the rights holders are offering competitors similar wholesale pricing. The retail price on the iTunes store is based on the wholesale price and includes in part Australia's own statutory royalty payments, publishing fees and the GST. In both Australia and the US Apple earns a margin from the sale of movies, music and TV shows which is used to pay for the costs incurred to store, manage and serve all of the iTunes store offerings. To be clear: the iTunes store operates through the local Apple entity in Australia. As I have explained, the retail pricing of digital content is based on many factors and foreign exchange rates are not a major factor. The main differential is the wholesale price as set by the rights holder of the digital content. Our experience is that, if we can lower prices, we can drive a higher number of downloads.

I am here today to represent Apple in an effort to assist the committee in better understanding why there may be differences in the prices of products sold in Australia when compared with other markets. I would like to reaffirm Apple's strong commitment to provide our Australian customers with the world's best products coupled with an unrivalled user experience at a fair market price. I will be happy to answer any questions you may have.

CHAIR: Thank you, Mr King, and I am sure your evidence will be of great interest to the committee and to all those who have been following proceedings. Before we get to more detailed questions, one of the things I would like to ask is: notwithstanding the evidence you have given about the wholesale price and the charges that are perhaps, in effect, out of your control, in the era of the global consumer what ethical and economic justification is there for segregating markets and segregating consumers through technological innovation or technological mechanisms?

Mr King: Perhaps to talk through that, I will use a song as an example

CHAIR: Indeed, I think we have some examples ourselves.

Mr King: A song is an asset. It is a piece of intellectual property. The rights associated with that song may vary from territory to territory or market to market around the world. In this digital age, the content industry still perhaps runs with old-fashioned notions of country borders, territories or markets. When that song is licensed by iTunes for distribution, a condition that we must honour is to match that song to the territory where the rights are applicable. The consequence of that is that we need to set up iTunes stores in many markets around the world to match the content with the applicable territory for that song, movie or whatever the digital content item may be. That is the nature of the industry in which iTunes exists.

To better understand this matter, we urge the committee to discuss this with the folks who own the content. That would be the record labels, the movie studios or perhaps the TV networks, because they are the parties who control the rights and understand where those rights are available. They are in the best position to be able to respond to your question.

Mr HUSIC: On that issue, we have had previous evidence—you made reference here about royalties, for example. APRA appeared before the inquiry in July last year at our first hearing basically pointing out that about nine to 10 per cent of the cost is attributable to royalties and that GST and sales taxes roughly even out on both sides of the Pacific. We heard that this was effectively a battle between the DSPs and the record labels. Your evidence suggests that there is a degree of fluidity in the market and that you have to negotiate. But you have set price points in your music depending on—this is how it appears to me and you can correct me if I am wrong—whether it is a hit that is in the charts at the moment or something that is older.

I think that one of the things that is hard for people to understand is that if an Australian purchases an Australian artist's track from the iTunes store in Australia they will be charged more compared to a US consumer

buying that same Australian band's track in the US. You have these various price points. It is not necessarily fluid, and there are differences that cannot be explained. How is that the case?

Mr King: I will add some colour to this. I will break your questions down into a few components and we can drill into that. I will start with the components that go into the price of a song. The first building block within a song price is the wholesale price from the label to the retailer—I will come back to that. The second component is the publishing fees, which you have just mentioned, that are payable to industry associations. The third component for any retailer, including iTunes, is a cost recovery model to, in our case, cover the costs of running the iTunes store.

Mr HUSIC: Yes—marketing

Mr King: The fourth component is a tax. In the Australian example it is GST.

I will now drill-down into each of those. The first and most important building block is the wholesale price. That price is set by the owner of the content and is passed through to the retailer whether it is Apple, JB Hi-Fi or Sanity. As we look at the prices for music and movies across the Australian market and benchmark iTunes pricing to other retailers of music or digital content, the prices available in the Australian market are broadly similar, which suggests to us that the wholesale prices from the content owners to Apple are similar to the wholesale prices from the content owners to the other retailers. That is the lion's share of the cost equation for a song.

The next item is publishing fees. The nine to 10 per cent range that you cite is the number I recognise. We think those publishing fees are broadly similar in the Australian and the US markets. The costs incurred to run the iTunes store in Australia are broadly the same as running the iTunes store in the United States. There is no tax on that song in the US iTunes store, but there is a 10 per cent GST in Australia.

When you boil it all down, where may a price differential arise? It is in the difference in the wholesale price to the retailer. The other costs are either variable in nature, such as the GST, or comparable in nature like the publishing fees or the iTunes store management costs. Again, we urge the committee to talk to the rights holders to understand why there may be differential pricing to the extent that exists for one piece of content in Australia compared to the same piece of content in the United States or indeed any market around the world. That is a matter that is controlled by the rights holders. I do not have insight as to how they run their businesses or the unique costs that they may incur in running a business in Australia that are not the same as in the United States.

Mr HUSIC: We have two different groups of people who point the other way when it comes to responsibility for the price. You have indicated that the record labels need to be held to account. I am paraphrasing that, but you are saying to direct the questions to the record labels. The record labels say that they negotiate with Apple, Microsoft and other platforms that provide the music. Ultimately, from what we understand, 60 per cent of the cost is really driven by the digital provider—you in this instance. We have had evidence put to us that that is the case. If you are saying that there are roughly equivalent cost structures on both sides of the Pacific, why will you not open up the US iTunes site to an Australian user so that they are able to effectively use the internet to get better prices and make globalisation work in their favour?

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

Regarding the point of allowing an Australian consumer into the iTunes store in another market place, that goes to the rights tagged to an individual piece of intellectual property—the song or the movie. When that asset is licenced to iTunes for distribution, a condition of that negotiated agreement with the rights holder is that we make it available only for specified markets. Many rights are still, today in this digital age, on a territory by territory or a market by market basis. There are very few rights that are truly global. That creates confusion for customers and it is certainly something that we would suggest that you talk specifically to the labels or the studios about, rather than an industry association that sits in between those groups and the community. It is the folks who actually own the content that know this topic the best. There may be reasons for that wholesale price to be higher here than in another market. I am not aware of those reasons, and that is why I think it is best to direct this question to the folks who own the rights.

Mr HUSIC: So just coming back to that question: are you saying that the reason that Australian consumers cannot access the US iTunes store is copyright?

Mr King: Correct.

Mr HUSIC: Would you support, for example, harmonisation of those rights through trade agreements?

Mr King: That is really a question for the rights holders. We are a retailer of the music and so the conditions that we have to respect are the current intellectual property conditions that are between the rights holder and ourselves. Speculating on what may or may not exist in the future is not something that I am qualified to do.

Mr STEPHEN JONES: I will follow up with a similar line of questioning as Mr Husic, if I may. When I talk to farmers in my electorate—and there are a few—they complain about the relationship they have with their biggest client, which is generally Woolworths. They say: 'We've got no power in this negotiation. If you want to sell vegetables in Australia you've got to sell them to Woolworths. We can get a bit down at the local farmers' market, but, basically, if you're not selling to Woolworths you're not in the game.' I would be surprised if music wholesalers are not in a similar position when it comes to Apple. If you are not selling to Apple, if you have not got your product on iTunes, you are not in the game in the modern music market. You are not a minnow in the market, are you?

Mr King: I would suggest that we are probably not a minnow. The digital music industry is still a very nascent industry; it is still evolving. iTunes is not even 10 years old. The uptake of digital music in the past 10 years has been tremendous, and we are always pushing ourselves harder to think about what customers would enjoy more around digital content. To answer your question: we are not a minnow, but there is a very competitive landscape for music in Australia. Customers have lots of choices as to the way they may wish to buy their music. There are download services such as iTunes, there are streaming services—

Mr STEPHEN JONES: I get all of that, Mr King, but if you are an artist wanting to get yourself into the national or international market, you want your stuff on iTunes, don't you?

Mr King: We would hope so.

Mr STEPHEN JONES: I would suggest that that stands for itself. I just want to interrogate this issue that you are pretty much a price taker when it comes to the prices that you pay for access to digital rights in Australia. That just does not seem to pass the common-sense test. You are the biggest players in the market, surely you have some influence over the wholesale prices that you are paying for your video and music content in Australia.

Mr King: The content is not owned by Apple.

Mr STEPHEN JONES: I understand that fully, but you pay a price for it. I imagine every artist in Australia would want to get their gear on your site. The point I am making is that if you think that the landscape is not fair, or is not right from a consumer perspective, you have a bit of power in that, haven't you?

Mr King: We are a large retailer. We would never—

Mr STEPHEN JONES: But you are also a large purchaser, a very larger purchaser, and that is the point I am making.

Mr King: We do not purchase the music; we licence it for distribution. I go back to saying that the content is owned by someone else—that is, a digital rights holder that may be a label or a movie network. If you compare what is going on here to the way our pricing model works for the products that we own, we have a very narrow differential with the Apple-branded products compared to the United States. We would love to see lower prices on content in the Australian market—we are very serious in making that observation—and the difference in a price will stem from the difference in a wholesale price from the owner of the rights.

Mr STEPHEN JONES: Yes, I understand that. But I go back to the point that I made in the Woolworths versus the farmer analogy.

Mr King: Mr Jones, we are not Woolworths.

Mr STEPHEN JONES: It is an analogy, Mr King, and I think you understand the analogy that I am making. I will go to a second line of questioning. The genius behind the Apple digital distribution model for your apps and your Apple-branded apps is that it is too cheap to cheat. At somewhere between 99c and \$1.99 for your standard app, why would you bother cheating? That is within the price range of anyone. When customers are looking at these large price differences between what they would pay in Australia and what they would pay in the US for video and music content, doesn't that break down the genius of the philosophy that lies around apps? Isn't it almost an invitation to cheat?

Mr King: Clearly the greatest demon that the content industry has faced for 15 to 20 years has been piracy. When we brought the iTunes store to the market almost 10 years ago, our business model was to strike this balance between a fair return for the content owner, or indeed the artist, and a price that consumers felt good about. We do acknowledge that there are some differentials in content pricing on the Australian iTunes store compared to the US store. We would point to where the source of that differential arises—that is, in the wholesale price. We would love to see lower prices for content on the Australian store, but we would urge the committee to

talk to those folks who own the content, because there may be reasons why that content is priced the way it is in Australia. Again, I am not aware of those reasons.

To use your milk farmer analogy, there will be costs for the milk farmer when doing business that they are careful to take into consideration. Unilateral observations on pricing models will run parties into difficulty in drawing conclusions. My strong suggestion is that all of the elements of the food chain, so to speak, are brought in for discussions in this area. The Australian music industry is an incredibly vibrant music industry, and we have just recently seen some wonderful recording artists do incredibly well overseas. They are wonderful, humble folks who have done a brilliant job celebrating their craft on the world stage. I would hate to see moves taking place in the content industry in Australia that stopped that next recording artist coming through.

Mr STEPHEN JONES: I could not agree more, Mr King, which is why this second line of questioning I am pursuing with you is about the sustainability of an industry structure. I will ask you straight up: do you think this geovariance in pricing is sustainable over the long term? Is it something that you have built into your medium-term business model? Because it strikes me that, when one in three Australians is jumping on a plane every year and having their holidays in new regions, they can bank up their purchasing choices for that holiday—and it is not just Hawaiian shirts and thongs that they are going to be bringing home, it will be a lot of their entertainment as well. Does Apple believe that this is a medium-term, sustainable business model?

Mr King: I will point you to the pricing model that we use with the products that we own. They are our hardware and our software. Our software products are priced today essentially at parity with the same products in the United States.

Mr STEPHEN JONES: You have made that point well, I think.

Mr King: Frankly, we would love to see lower content prices around the music and movie areas, but it is difficult for me to walk into this room and talk on behalf of the labels because I am not the labels. But there is a balance—I completely agree with you that a balance needs to be struck.

Mr STEPHEN JONES: Thank you, Mr King.

CHAIR: Just following Mr Jones's analogy, it might not be a farmer dealing with Woolworths so much as two big parts of a market. We are talking about artists, but we are more often talking about big record labels which have similar corporate arrangements to Apple with an Australian subsidiary of an international company. Recently we have seen the governments of New Zealand and Australia say to the telecommunications industry, 'If you don't lower global roaming prices, the governments will take steps to make for more competitive markets.' I wonder what your thoughts would be if the government said to industry, 'Look you have got address this issue; you should address this issue.' Do you have any thoughts about that?

Mr King: Are we sticking to digital content?

CHAIR: Yes, Mr Jones said that you have made the point well about that on other matters.

Mr King: Bringing the folks who own and control that content to the table to talk to why there may be differences in pricing is critical, because there may indeed be reasons why a song or a movie or whatever the asset may be may be priced here at a different price to New Zealand or the US or the UK. It is really a question for other folks.

CHAIR: Should Apple be at the table while the content providers are at the table? Should you all be at that table? I guess that is the question I am asking.

Mr King: I am here today, certainly, to answer all the questions. Everyone should get their day in the sun, so to speak. If there are follow-on questions for us that come out of that session, then I would be delighted to respond.

CHAIR: Ably answered, Mr King.

Mr SYMON: Although you are here for your day in the sun, it has actually taken the committee quite some time to get you here. I was wondering why the reluctance of Apple, and indeed others today, to appear at a public hearing. What normally happens with public hearings on the many committees that we all serve on is that people or companies are invited to appear to put their case, and we have struggled to get you to this table and have your day in the sun. I would like to try to understand some of the reasoning behind that.

Mr King: It is indeed rare that Apple makes a public appearance, particularly to talk about public policy matters. However, back in July we provided a submission to the committee. That was a confidential submission, and we later agreed to make that public. We also attended a private meeting with the committee to answer questions, and I think that was a fairly constructive meeting. Today I am here to answer any other questions that the committee may have.

Mr SYMON: I shall have some of those 'other questions'. I would like to go back to what we were talking about with the other members with regard to music. You have described yourself as a retailer of music. My problem here is the issue of parallel importation. A music retailer who sells music physically recorded in Australia has for many years been able to import that product from elsewhere. There was a time when it had to be produced in Australia. That changed. We now seem to have got back to where we used to be, except it is in the digital sphere rather than someone having to go down a local record shop and buy an LP. Why, in your view, is it the case that digital is treated differently, in minds of the rights holders, to the physical product?

Mr King: I do not know the answer to that question. This is a great question to ask the folks who own the content. We are a retailer of content in the same way that JB Hi-Fi or Sanity would sell content. We are the same retailer as a bricks-and-mortar retailer. I would ask that you address that question to the people who understand the content story far better than I do, and they would, I am sure, be able to give you a good answer to your question.

Mr SYMON: Okay. Switching over to hardware products, I have noted in your submission that prices for hardware are now as good as or similar between us and the US. I know that was not always the case, and the question I want to ask in that area is: is that because that was the price that it was thought the market could bear, or was that, as you were talking before, about the need for a higher margin in Australia because of added on-costs? In other words, what are your company's costs in Australia that cause, or have caused in the past, that price to be higher than in the US?

Mr King: I will just draw you to the last paragraph on the second page of my opening statement where I have listed for the committee the costs that we take into consideration with all of the Apple owned hardware and software products. I will start with the exchange rate, and I might come back to that in a moment. The other key areas will be freight, any duties that may or may not be applicable on a product, the economics of running channel or partner organisations, right through to advertised prices. For example, advertised prices in Australia, as we know, must include a GST. We do, and have, for as long as I can remember run an overall model where we offer equivalent pricing on our products around the world. We establish that equivalent price at the time we introduce a product to a market. In the last 12 months we would have updated, launched new products, perhaps 100 times across all the individual skews and products items that we have for sale in Australia. We are doing that times all of the different countries that we operate in around the world. That is an incredibly complex pricing model to run, so we do need to bring simplicity to that model as we are managing dozens and dozens of countries around the world times many, many different products and product prices.

Simply put, we offer an equivalent pricing model rather than the model you are suggesting about what a market may bear. We start with a US denominated price. We do take into consideration some costs of doing business in a market. That may be in the area of freight. The per unit freight charge of an iMac, for example, is more expensive to bring into the Australian market than it is to other markets. Again, as we distribute that product around this vast country, it is more expensive to air or truck those products around the country compared to a market like Singapore, for example. They are the things that we take into consideration. It is a cost model rather than this other model that you were referring to.

Mr SYMON: Following on with hardware, we have spoken about music and therefore, I suppose, software having regional coding or regional rights. Do you have any hardware products that only work in particular regions? Are they geo-blocked so that they cannot be taken from one country to another?

Mr King: We will have slight permutations in hardware that need to be compliant with regulations in certain markets. There could be cellular requirements that differ on a market-by-market basis. Broadly speaking, our products of the same around the world.

Mr NEVILLE: Mr King, you make some reference in your submission to GST as if that were some defining matter in Australia and that there is no sales tax in the United States. I presume you are talking at the federal level?

Mr King: I am purely talking about the way in which prices are advertised. In Australia, of course, we have to include GST in the advertised price. It is not the same in America. It will be included in the final bill but, if you go to a website in America, the sales tax will not be sitting there within the advertised price. The price references that we have put forward today exclude taxes in Australia and in the US.

Mr NEVILLE: That is not quite what you have said. You have said:

It is important to remember that US retail prices do not include sales tax.

You did not say 'advertising them does not include sales tax'; you make the statement that they do not include sales tax.

Mr King: I will make the correction. That should include 'advertised'. But in the—

Mr NEVILLE: Is it not also true in the United States that a number of states have sales taxes or VATs?

Mr King: My understanding is that in America there are both state taxes and city taxes in some areas.

Mr NEVILLE: And you pay those in the normal course of events?

Mr King: Yes.

Mr NEVILLE: And is it not true that there is a higher level of VAT type tax in the United Kingdom and in New Zealand?

Mr King: That is my understanding as well.

Mr NEVILLE: Doesn't it strike you as strange then that Australian prices seem to be so much out of whack with US, Canada, UK and even, in some instances, New Zealand?

Mr King: Apple branded products are not out of whack with the US or these other markets. The numbers I have put forward to the committee today are on a basis that does not include tax. It is a like-for-like basis, so we do not have to factor in a GST or a VAT that may exist in other markets. That is the way I presented the information today to be as clear as possible. However, some jurisdictions around the world, in terms of advertise prices, choose to have laws in place that include or do not include their local indirect taxes.

Mr NEVILLE: I have a scale here of various products of popular music items: Carly Rae Jepsen, we pay 67 per cent more for a single in Australia; Florence and the Machine, 49 per cent; Led Zeppelin IV, 85 per cent. Are you saying, and it is certainly the drift in your evidence, that those disparities are imposed on you by the wholesale price of the owners or the distributors of that product?

Mr King: Yes, I am.

Mr NEVILLE: Can we then take it that those prices are a direct correlation with how much more you are paying at the wholesale level? Or are they just that you are going to pay a bit more in Australia? If we took the Led Zeppelin item, for example, could we say that you would be paying 85 per cent more in Australia than you would be paying in the States? Is there a direct correlation between what Australians are buying and the wholesale price you are being charged?

Mr King: Yes is the answer to your question.

Mr NEVILLE: In percentage terms?

Mr King: So if you were to lower the wholesale price of the Led Zeppelin album or song to be the same as the United States, we would see that come all the way through the pricing model to provide a parity situation.

Mr NEVILLE: At a direct correlation level?

Mr King: Correct. The area that I am not an expert in that may come into play here would be whether there are variances in publishing fees for that song in the United States versus Australia, so that is a good question for those folks. Obviously we have talked about the taxation point—that needs to be taken into consideration—and then the Apple costs would be similar in the two scenarios.

Mr NEVILLE: Could you describe, for the purposes of the committee and the gallery, what type of product the Apple Time Capsule, the ITB?

Mr King: The Time Capsule is a backup product to store your information.

Mr NEVILLE: And is that one of your in-house products, as distinct from a product that you resell?

Mr King: Correct. It is a product that Apple owns.

Mr NEVILLE: Well why do you charge 29 per cent more for that in Australia? If it is not being imposed on you by a wholesaler, why would you charge 29 per cent more in Australia than you would elsewhere?

Mr King: As I went through in my opening submission, I took the committee through how we establish a price, and we do hold that price until the time that we transition the product. So we will—

Mr NEVILLE: Yes, but as a cushion against transitional costs, 30 per cent is pretty hefty, isn't it?

Mr King: And we have seen, in other time periods, the reverse scenario, where we have prices in Australia be 20 or 30 per cent lower than prices in other markets around the world when the Australian dollar has fallen.

Mr NEVILLE: And how often do you adjust these? The Australian dollar has been around parity or higher than the American dollar for some time now. Have you sought to adjust that in any way?

Mr King: A global model is to adjust our prices at the time that we transition or update the product. That applies to all of our Apple branded hardware and software.

Mr NEVILLE: That will do for the time being, Chair.

CHAIR: Thank you, Mr Neville. I guess 'the song remains the same', as Led Zeppelin said.

Mr HUSIC: I was going to come back to a point you made earlier. Apple compared itself to JB Hi-Fi, but, with respect—if I can just play a role I am very comfortable with of a contrarian—JB Hi-Fi is not the largest company on the planet in terms of market capitalisation. Apple is. What is suggested here today, Mr King, is that Apple does not have the power to influence prices, that this is set by the record labels. But it a fact that there are three price points that are set in place and that Apple does have enormous market power to be able to influence it. It may be lack of comprehension on my part, but I do not think anybody is really any wiser as to why it costs more for an Australian consumer to purchase an Australian artist than it does for a US consumer buying the same artist or track and yet Apple is saying that it cannot influence that.

Mr King: We have seen the price of digital content slowly reduce in Australia. We have seen that. We would love to see those prices continue to come down. I have made this statement several times: we would love to see lower prices for digital content—and that is not just music; it would include TV shows and movies. But the cards, so to speak, are in the hands of the folks who own the content. They are not in our hands to play. And so we would urge the committee to talk to the content owners, to understand why there may be differential pricing, because it is not a matter for us to control. We do not own the products, other folks own these products.

Mr HUSIC: People have been listening to your responses and they have raised, via Twitter, this issue: they have compared Justin Timberlake's latest album that has been released—they are comparing the prices per track between Apple and BigPond, where you are charging \$2.19 a track versus BigPond's \$2.05. I know it is not a massive differential, but it does come back to the point about why is there that difference? You are saying it is wholesale, but you have people competing against each other that are charging differently.

Mr King: We operate in a competitive retail environment, absolutely. I do not have an insight as to how BigPond runs its music business. I am sure that, if I went through and did an analysis of the pricing of individual songs and albums between Bigpond and iTunes, there would be puts and takes throughout the entire analysis. So I leave that to a question that you perhaps could ask the folks at Bigpond. I do not have an insight into their pricing model.

Mr HUSIC: I go to the issue of copyright. Particularly for the US, which is a massive innovator, you will want to protect your content, and copyright is there to do it. Understood. But through the years we have seen, including in legal decisions that have been carried out this week, that you cannot use copyright as a mechanism to protect your economics. That is, you cannot regionally price or put in, in effect, regional mechanisms that prevent consumers from using your product. Yet Apple still region codes. For instance, I have purchased a MacBook Pro from the United States a few years ago because, with respect, while I agree that the prices have moved to parity they were not a few years ago. If I go to use a US DVD in a MacBook Pro, I am only given a few opportunities to use a US one before I am told I am going to have to revert to the market or region that I operate in. Under the US-Australia Free Trade Agreement we have prevented region coding and the blocking of content, so why is it that it is still maintained that way?

Mr King: We take great care to protect intellectual property, be it ours or other parties', to the extent that, if any of those items take place with any Apple product, it will be in response to the protection of intellectual property at a market level or at a global level if that is the case.

Mr HUSIC: In terms of the channel economics that you referred to earlier, do you set guidelines to people who have relationships with you in the channel for how they offer your product?

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

Mr HUSIC: So you are saying definitively that Apple does not set the price with the channel; it only sets the price going in, and what comes out is up to the reseller.

Mr King: Absolutely.

Mr HUSIC: Okay. I think people who are listening to the broadcast would express a different view: when they go to buy Apple products, they see everything, from the way the product is displayed in a store at JB Hi Fi or elsewhere through to even the actual price listings themselves as standardised. More importantly—I am not

interested in the font but am interested in the price—the prices between stores, differently from how you have outlined, are pretty much harmonised between stores.

Mr King: We would take great interest in the font.

Mr HUSIC: I understand that.

Mr King: We take great interest in the way our products are displayed across the market. It is something we are very passionate about. But the number that goes into that display that sits on the table is entirely in the hands of our retail partner. It is not set by Apple.

Mr HUSIC: You are saying that you track the prices of the 6,000 outlets that operate within your channel and that there are large degrees of variation within those 6,000 outlets.

Mr King: Every week we see partners doing wonderful things with the way they represent our product in the marketplace. If they choose to do something with the price of our product to the market, that is their decision and their decision alone.

Mr HUSIC: It is fair to say Apple does not manufacture its own product here. You do not contract anyone to do any manufacture here, do you?

Mr King: We do not do any manufacturing of Apple hardware in Australia.

Mr HUSIC: R&D?

Mr King: We do not do any research and development in Australia; however, we provide assistance to the enormous community of app developers who are developing apps for the app store, which has created this wonderful new market for many developers in the Australian market.

Mr HUSIC: Yes, you fund it. That has been a massive transformation. So it would be an agreement between you and your Apple US parent in terms of obtaining hardware to sell here. iPads, iPhones, MacBooks are all purchased from your overseas parent?

Mr King: Correct. Apple Australia would purchase hardware and software from Apple overseas.

Mr HUSIC: So the price is set between the two. Where would you import the product from?

Mr King: The majority of the product would come from manufacturing sites in China.

Mr HUSIC: So how are the negotiations for the purchase price determined?

Mr King: We are very clear in the way that our revenues, cost of sale and any of our local operating costs are registered to the Apple Australian entity. We have very robust and deep accounting systems in place to ensure that all of the revenues associated with doing business in Australia are fairly reported and all of the cost of sale in terms of the hardware, transformation costs and shipping costs are fairly reported—as indeed, are all of the local operating expenses in doing business in Australia. And those numbers are considerable: we employ 2,600 people around the country. We have 18 retail stores. We have operating leases. We have considerable costs incurred in the sales and distribution of our products within the Australian market.

Mr HUSIC: So you itemise all those costs in the course of the negotiation with the US arm and then determine a price from that?

Mr King: Our product costs are a function of many component and transformation items. I am not privy to all of those numbers that might come together within our global financial systems.

Mr HUSIC: What I am asking is: is it, in effect, a fluid negotiation where you work out with the US parent what the price will be, or does the US parent basically set the price and you import at, effectively, the transfer price?

Mr King: Certainly at a global level we are setting consistent product costs for internal use around the world. Those are a function of a number of different things, but I am not privy to the underlying details within the product costs.

Mr HUSIC: So there is an overall price set for those factors you mentioned before, but do you then factor in to the US parent the types of costs that you claim you have to face here, including taxation?

Mr King: In terms of the way in which we set a price for a product—I think that is where you are headed—I draw you to the last paragraph on page 2. They are the factors that we take into consideration in the way that an Australian dollar price point will be set for a piece of hardware. That will start with the product cost. It will then take into consideration—

Mr HUSIC: The product cost which is the uniform global cost?

Mr King: Correct. That will then be translated into local currency based on prevailing exchange rates. We then take into consideration whether there are any unique characteristics associated with doing business in a market. That might be freight—whether something will be moved by sea or by air; the distance we need to cover. We have great experience in this area, so we know how much a freight charge will be for a product freighted from China to the US versus Australia. Whether a levy or a duty is applicable for a particular market will be taken into consideration, and then we get down to the local costs within a marketplace as well—for example, is there anything that is unique in Australia that needs to be taken into consideration? Then we get into indirect taxes—for example, the GST.

Mr HUSIC: To be more specific in my questioning: is the global cost that you mentioned earlier the cost that you purchase at from the US or do you, through a process of discussion with your US arm, factor in those types of costs that you have mentioned and then is that the price at which you transfer product to Australia?

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

Mr HUSIC: How many iPads did you sell—iPad2 or iPad3—last financial year in Australia? I am not asking about revenue, but volume or number.

Mr King: That is not a number that we discuss in public. I would be happy to discuss that in camera.

Mr HUSIC: Okay. If, for example, you had a million iPads, what price would you purchase them for? Would it be the global price that you work out with your US parent or is it the global or harmonised price plus all the add-on costs? What is the exact point at which there is an agreement on transfer price between you and the US?

Mr King: It starts around a discussion of a unit of one. So, the volume consideration is not there. It is a unit of one consideration. We have product cost, translation to the local currency and then these other factors that may or may not be relevant in a market like import duties or GST or other factors like that.

Mr HUSIC: So the US says: 'We take into account that and we are selling you this product via a transfer price agreement at X.' Is that what happens?

Mr King: The product cost is set at a level that is broadly consistent in markets around the world in US dollars and then translated in local currency.

Mr HUSIC: Who translates it?

Mr King: We have a global team who looks after all of our product pricing around the world and they are based in the US.

Mr HUSIC: Mr King, I am not understanding this. Who makes the final decision on price? Is it the US parent or is it you?

Mr King: We set our prices worldwide from Cupertino with input from the local team for factors that may be relevant for the Australian market. We have a global equivalent pricing model that is established at a worldwide level.

Mr HUSIC: I don't think I will get an answer.

CHAIR: You can ask another question.

Mr STEPHEN JONES: Apple, as a large transnational corporation, would have some control over what costs are borne in a particular jurisdiction by a particular entity within the corporate structure. Is it the case that the costs that are booked against doing business in Australia are uniquely Australian costs?

Mr King: We have two broad levels of costs. One is the cost of sale, the cost of the hardware, the transformation or the product cost, as we have just discussed. The second line item is all the local operating costs. There will be headcount in Australia, facilities in Australia, the cost of generally doing business in the Australian market.

Mr STEPHEN JONES: The Australian entity within the Apple global does not pay any more or, presumably, any less for any of those corporate services that they receive all benefits that they receive from Apple HQ than any other entity around the country? If I were to look at, line item by line item, the charge that is described in your books for services that you receive from Cupertino and I was to then check that against what was being credited in Auckland, I would see, line item for line item, the same charge.

Mr King: Mr Jones, to the best of my knowledge, that is correct.

Mr NEVILLE: How do you operate in Australia? Do you operate an American company selling a product in Australia or do you have a wholly owned Australian subsidiary?

Mr King: We have a wholly owned Australian subsidiary, Apple Pty Ltd. I have worked for that company for 10 years.

Mr NEVILLE: Does that company report to the Australian Stock Exchange?

Mr King: We file annual accounts with ASIC but it is not listed on the Australian Stock Exchange.

Mr NEVILLE: I take your point. What proportion of your international market does Australia represent?

Mr King: We do not break the Australian numbers out in our worldwide accounts, but we do publish our Australian revenue, so you can probably back into the number. The Australian business would roughly be three per cent of Apple's worldwide business.

Mr NEVILLE: Is it more or less profitable than your other markets?

Mr King: Mr Neville, I am not familiar with the P and Ls for all of the Apple entities around the world, so I would find that difficult to comment on.

Mr STEPHEN JONES: I am sure that, when you go back to Cupertino for your annual love-ins, there is a bit of competitiveness and bon homie amongst your equivalents in other parts around the world. I would find it very hard to believe.

Mr King: Mr Jones, we enjoy wonderful competition within the company and we have great fun challenging our friends in Canada and other markets to all sorts of friendly challenges. We may talk in terms of revenue, but that is all we ever talk about in terms of benchmarking entities internally. I am a sales guy so that is what I focus on.

Mr STEPHEN JONES: I would find it very difficult to believe that you would not have a pretty good understanding of how you are performing against some of your other colleagues around the world.

Mr King: In the context of revenue, I would have a good understanding, but I am not familiar with the full P and Ls for any of our entities around the world.

Mr NEVILLE: Are any of the South Pacific countries supervised by the Australian subsidiary? Do you look after, for example, Papua New Guinea, Fiji, New Zealand? What is the extent of your territory?

Mr King: As I said in our opening statement, I look after Apple's activities here in Australia and in New Zealand and in some of the countries in South Asia.

Mr NEVILLE: How much tax do you pay in Australia each year?

Mr King: Our income tax expense numbers are not on the public record in the same way that any other company in Australia does not have their tax details on the public record, nor does any individual. I will give you some colour as to how our tax returns, so to speak, might sit.

Mr NEVILLE: Are you giving us that publicly or confidentially?

Mr King: I am happy to talk in generalities around the components of our tax return and the process that we go through with the Australian tax office every year. That process is very open, rigorous and transparent. We report to the ATO all the revenue that we derive in the Australian market. We report to the ATO all the costs of doing business in the Australian market, from product costs to all of our operating expenses. That brings us down to a net profit number. That net profit number is a number that we are very open about with the Australian tax office. They know our revenue, they know our costs and they know all of the details about the way in which we have financial affairs running in any particular year. Against that net profit, we apply the 30 per cent corporate tax rate for Australia and we pay our tax expense. We pay our taxes when they are due—not only income tax expense but GST, payroll, FBT and any other tax that might be incurred in doing business in Australia.

Mr NEVILLE: I am still bewildered as to why in the music and iTunes field Australia pays so much higher than other countries. You have said in evidence that the retail price bears a direct correlation to the wholesale price that you are being charged. As other members of the committee have said, you have enormous muscle at an international level. Have you ever challenged those companies on the wholesale price they are charging in Australia? What is your take on why they would single out Australia? If there is a direct correlation—and the other companies we are seeing today have had a similar experience—we are probably talking between only three and five per cent of the international market. Why would they single out Australia for special attention?

Mr King: I would urge you to address that question directly to the labels, but I will give it a go. We would love to see prices of the digital content being lower here. We do make that point to the labels as we meet with them on a continuous basis. We have seen a slow but steady drop in digital content pricing in Australia over the

last couple of years. But your question is best directed at the guys who own the content and the music. They will be able to give you an answer to this question, I am sure.

Mr NEVILLE: Are most of the major labels represented in Australia?

Mr King: I believe so.

Mr NEVILLE: I know they all have representatives at the desk-selling level but, when we are getting into downloading and other matters, do they have a full structure on the electronics side of their business in Australia?

Mr King: To the best of my knowledge, absolutely yes. They have a local operating or representative office of some description and would have teams that could talk to both the physical and the digital sides of their businesses.

Mr HUSIC: Can I go back to something that we started talking about, Mr King, and that was about the way you set your prices. I also want to touch on something that Mr Neville, the deputy chair, covered off with you. We are all friends in here. I know you did not want to necessarily indicate the tax bill, but it was reported earlier this year as a result of information obtained through ASIC that on the basis of generating here in Australia \$6 billion in revenue Apple paid only \$40 million in tax. Apparently that is two-thirds of one per cent of your turnover. You do not manufacture here. You do not conduct R&D here.

I am going to put something to you, which I would welcome your response to. It is not all these other add-on figures that are set. On the issue I was referring to earlier, about where exactly is the point at which you set the prices: is it set by the US before it agrees to a transfer price on product? You set your prices based on what you believe is in the best commercial interests of the company, obviously; but taking into account taxation as well. I put it that the reason why Australian consumers pay more has more to do with your transfer price than anything else.

Mr King: I would disagree with that statement. I would start with the observation that our software is essentially priced at parity to the US market. Our hardware today is marginally above the prices for the same hardware in the US market. With respect to taxation, we pay all of our taxes in Australia—

Mr HUSIC: I am not doubting that, Mr King. I am not suggesting that Apple does not pay tax. I am saying that the way you set up your arrangements—

Mr King: And those arrangements, so to speak, are quite simple, Mr Husic. We clearly record and report the revenue that we derive in Australia. We report to the ATO all of the costs associated with doing business in Australia. The ATO is the referee, so to speak, in the middle of this. We have a very open, frank and candid dialogue every year with the ATO about our tax affairs, which includes, like any company, our revenue and our costs down to our net income. They are really the three items that are relevant for our discussions with the ATO. We track all of the revenue that we derive here. We track and report all of the costs associated with doing business, which brings us to the net profit number. We have a very good relationship with the ATO, and I am sure our tax guys absolutely love it whenever they have to spend time with the folks down the road!

Mr STEPHEN JONES: (*Inaudible*) not your relationship with the ATO—I am sure that is very warm and fuzzy, as is mine! Does Apple have a policy of market pricing for allocating costs between its country entities?

Mr King: I am certainly not familiar with any practice like that. I would say that we do not. We are very clear in our income statements, where we have revenue, products costs, operating expenses—and they are really the three lines. The product cost manifests itself in that physical piece of hardware that you have in front of you today. The operating expenses are clearly tagged to employees, to buildings and general costs of doing business. Our tax affairs in Australia are very straightforward—

Mr STEPHEN JONES: Can I interrupt. I don't want to stop you from answering the question exactly the way you want to answer it but, when I ask you about whether your allocation of costs between countries are done on a market basis, what I mean is: is there a transparent pass-through of costs from one part of the Apple entity to another on a market basis? You answered no. That surprised me; that seems to contradict the suggestion you were making in earlier evidence. I use that language quite deliberately. I am familiar with large manufacturers in my own electorate who, when they sell steel slab to another part within their entity, in another country, they do it on the basis of a market price—that is, one part of the business neither subsidises nor loads up the price they pay to another part of the business. That is what I mean by 'market pricing'. I am giving you the opportunity to perhaps correct, or be very clear about, the response you have given me to that answer.

Mr King: Mr Jones, if there are any specific questions around our product costs that you would like me to take on notice then I am happy to take those questions on notice.

Mr STEPHEN JONES: It was a high-level question: is there a policy within your company that says, 'We allocate costs on a market basis'?

Mr King: I am not aware of a policy along those lines.

Mr STEPHEN JONES: Thank you.

Mr HUSIC: Going back to when we were talking about the channel, I am going to ask a question that I think I know the answer to already—but it is worth a shot! What are the retail margins on a product like an iPad?

Mr King: That information is commercial-in-confidence.

Mr HUSIC: Come in spinner! Okay, let me put a statement to you for a response. People cannot haggle down a price, because Apple sets the recommended retail price higher. What is your position on that?

Mr King: My experience is that I see great competition with customers buying our products in the Australian market. For example, if a customer brings an ad into one of our retail stores, showing the price is cheaper down the road somewhere else, our Apple retail stores have a price-matching policy. But I see a great degree of competition in the Australian marketplace, and that spans across all of our products. And I have seen that for the 10 years that I have been in the job.

Mr HUSIC: Okay. Final two questions—one goes back to something Mr Neville mentioned, and that is about music. One thing that struck me is that these record labels are global. You are obviously a global company. It was suggested that we need to go back to the record labels, but these negotiations are taking place at a higher level. I come back to the point: if globalisation works—which it does, and has great benefits in opening up markets to business—it should also operate in the same way for consumers. Why is it that global record labels, a global player like Apple, cannot deal with establishing a better price on music?

Mr King: Our experience is that a lot of the decision-making within the labels is not global—hence why I am asking you to speak to these guys, to understand why there may be cost differences in their products here versus other markets around the world.

Mr HUSIC: Have you had conversations with your colleagues in Cupertino about the discontent that exists here with price discrimination and how it is affecting your relationship in the Australian market?

Mr King: We are acutely aware of customer feedback in general. We pride ourselves in excelling in the area of customer experience. So we are acutely aware of headlines that might be reported in the newspaper, or a letter we may receive from a customer who is concerned that a song price on iTunes in Australia may be more than in the US. I have a very frank and candid dialogue with my counterparts in the US to make sure that they understand this. Indeed, at a global level, within our iTunes teams, we do pass the observation to the global head office of a music label that we are hearing comments in Australia that frankly make us uncomfortable. But I do believe that a lot of the labels operate more on a territory-by-territory level rather than as one unified global entity.

Mr HUSIC: Thank you.

CHAIR: Thank you, Mr King. We welcome your evidence here today. I am sure I speak for all the committee members when I say don't be shy in the future, when you get a request to come before the committee, because your evidence has been very illuminating for our deliberations. If you have any additional information you think would assist the committee, please provide it to the secretariat. Thank you for being here today.

Mr King: Thank you, Chairman.

ROBSON, Mr Paul, Managing Director Australia and New Zealand, Adobe Systems

CHAIR: Welcome. Although the committee does not require you to give evidence under oath I should advise you that this hearing is a legal proceeding of the parliament and therefore has the same standing as proceedings of the House. We have received two written submissions from you, which we have numbered 81 and 81.1. I now invite you to make a short opening statement and then we will proceed to questions.

Mr Robson: I thank the committee for its time this morning. I will start off by sharing a little bit of information about our organisation for those of you who do not know much about Adobe. We have two main businesses in the market: a digital media business and a digital marketing business. Our digital media business provides a suite of software that allows creative professionals to publish, create, promote and monetise rich content across multiple platforms, including magazines, websites and other digital imagery. You may be familiar with products such as Photoshop, Illustrator, Acrobat and the like. Our second business is a digital marketing business which is focused on helping major brands around the world and in this country manage and optimise digital marketing spend across all channels.

Here in Australia Adobe plays a central role in the Asia-Pacific region. For many years the Sydney based employees of Adobe have been the backbone of our expansion into Asia. The calibre of talent in the Australian market is very strong. This has been demonstrated over the last 18 months when we have nearly doubled the number of employees in this market to almost 200 people, many of whom have regional leadership roles and work across the region. Based on the calibre of this Australian talent our Sydney office was recently announced as a regional centre of excellence for enterprise engagement across Australasia, South-East Asia and South Korea, and from here I lead a management team that carries responsibilities across all three regions.

Through our chosen go-to-market model, which has historically been through a two-tier distribution system, we estimate that our business supports thousands of jobs within our partners, our suppliers and our resellers. Last month we continued this investment in the Australian market by opening a new office in Sydney's central business district. We were delighted to welcome the Minister for Broadband, Communications and the Digital Economy, Mr Stephen Conroy, and the New South Wales Premier, Mr Barry O'Farrell, to the launch event. In his speech Senator Conroy stated that Adobe's new office represents a significant investment and a commitment to the Australian market. He also noted that our investment was a vote of confidence in Australia's digital economy.

But obviously we are here today to talk about pricing. Firstly I would like to point to the information provided by Mr Geoff Francis, from Treasury, when he addressed the committee in October last year and add a few additional perspectives from my years of technology industry experience. It is widely agreed that economics around the production of software are very different from the economics around the manufacturing of manufactured goods. With software there are enormous upfront and fixed costs for research and development, IT expense and the personnel required for sales and marketing. These costs associated with the ongoing marketing, sales and channel development costs, as well as the media replication for the software, are lower compared with the upfront costs but they do vary from market to market. This makes the cost of producing software an extremely risky proposition as heavy costs are front loaded into the development of the software and they are completely unrecoverable if that software is not received well in the marketplace.

The history of the technology industry includes many examples of software companies that were unable to recover this cost of development. Many now-defunct companies invested heavily in developing innovative products for a short period but were unable to maintain the revenue streams required to support the cost of ongoing innovation to meet consumer demands. Companies with household names such as WordPerfect, Lotus, Netscape and Novell are all examples of this. They all had difficulty balancing the risky and competitive marketplace, steep development costs, the right pricing mix and the new innovation requirements of the marketplace.

For a software company the imperative when pricing is to recover the costs of development. If a company cannot cover its development costs, it cannot continue to invest and drive innovation on behalf of the market. The IT sector has moved from floppy disks to CD-ROMs, from CDs to DVDs, and from there to the cloud based technology that we see today. This is just the path of progress, and this path is accelerating. Software companies are under continual pressure to stay ahead of this innovation curve. Our product life-cycle requirements include delivering updates to adjust to new operating systems, to guard against ever-growing and costly security threats to our IP and to ensure that as new products are developed our applications can work seamlessly across them. One example of that is a recent explosion in mobility across smartphones and tablets.

Companies strive to find the optimum selling price in each market and we take into account the cost of acquiring customers and the price elasticity of demand. There is a high variability of costs associated with

operating a local business, developing the software and acquiring companies across multiple countries. This makes it difficult for a company to seek uniform pricing that adequately captures the revenue needed to continue local operations and ensure that we are able to continue to invest in producing the next generation of our products. Pricing in general is a highly complex situation and involves a lot of risk. However, Adobe seeks to set prices in this market here in Australia that provide a consistent contribution, taking into account the cost of doing business in this region and allowing us to run a regional operation. We do this in most markets around the world while at the same time trying to provide some uniformity across those regions. Here in Australia there are lots of products that we buy across multiple industries where we pay a higher price than in other countries. There are also instances where we pay a lower price. Treasury states in its submission that this issue is not new and it is certainly not limited to the IT sector.

Treasury noted that discounting is a form of differential pricing and has many social benefits. In the software industry discounts are common for students and teachers, not-for-profit organisations, government departments, businesses and organisations that purchase in large volumes. If customers do not feel that they are getting good value, they simply will not buy our products. Price is the key to competitive advantage which in turn underpins the global trading system.

You may be aware that the Adobe product set and the software industry are going through a period of significant change and transformation. By moving to office services online, as opposed to using traditional box product technology, Adobe has begun this significant transformation as we move our entire creative portfolio to what we call 'the creative cloud', which is available to customers via a subscription pricing model. Customers who subscribe to the creative cloud have access to virtually all of our creative offerings via electronic download. We believe that the future of our technology is this creative cloud—and our customers appear to be agreeing, with over 75 per cent of Australian customers purchasing from our website using this method of delivery. Creative cloud was launched in April 2012 and we have been monitoring and reviewing its performance in markets since its launch. Last month we made the decision to change the monthly price of creative cloud to \$49.99 on an annual subscription basis. This brings the price in Australia broadly in line with the price in the United States. Historically the price of our student and teacher offering for this cloud based service has been lower in Australia and New Zealand than in most markets around the world and is priced at \$24.99.

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

In conclusion, at Adobe we are acutely aware that we can only succeed if we deliver value and provide innovation to our customers that they think is worth the value of the product. If our customers believe they can get better value for money elsewhere, they simply will not do business with us. We have got every interest in pricing our products competitively for the Australian market and to continue delivering innovative new technology for customers. Thank you.

CHAIR: I will begin by putting to you the same question I put to Apple. We have a digital world and, in effect, global consumers—or global markets at least. I have no problem with companies recouping the cost and profiting from their innovations, because that is at the heart of capitalism. But I think what people object to is segregated markets. Do you think it is economically and ethically justified to do it?

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

CHAIR: You talked about the discounts you provide to students and the like. We received a submission from ACCAN about people with disabilities. Do you provide any discounts to people with disabilities?

Mr Robson: We provide discounts to a wide sector of the economy, based on the different needs and requirements. With specific reference to students and teachers, that is a very key vertical for us. We have worked actively with state education departments around the country with their education strategies around embracing and enabling students as they understand the new digital economy. We are very proud to play a very big part in

providing technology and software to help students better understand the future of what will be a digital economy. We also work with other areas. We provide a not-for-profit discount. We provide access to our technology for large businesses and large corporates at different pricing methods. As I said in my opening statement, we have a structure in place that provides detail on that.

Mr HUSIC: You talked about justifying geographic pricing on the basis of personalised services or products. How does Adobe personalise its products for the Australian market?

Mr Robson: When we look at relevancy around personalisation, that is in relation to the redirection of customers when they access our website. When customers access the Adobe.com website they can choose to see whichever website they wish to see. We automatically try to get them to look at the Australian site, for a number of different reasons. There is local content. There is information in relation to local user groups and communities that use our technology that they can learn from and contribute to. There is information that is relevant to the local market in relation to Australian based pricing and other content and information. That content is a richer and more personalised experience for an Australian customer than they would get if they accessed a webpage that was in another language or for another country.

Mr HUSIC: If an Australian consumer using your Australian website takes on board the information you provide and then says, 'Thank you very much, that is all great, but I'd like to purchase an Adobe product from Adobe.com,' can they do that?

Mr Robson: There are different variations of the Adobe.com site. We redirect them to the Australian price on that system.

Mr HUSIC: Why is that?

Mr Robson: We do that in order to capture the revenue that is relevant to the Australian market.

Mr HUSIC: I do not understand what that means.

Mr Robson: When you are running a global organisation such as Adobe, it is important to be able to track where the revenue is related to in terms of where the customer purchased from. That relevance allows me to make business investments in this market and go back to my headquarters and request further investment in this market. So for me to be able to specify which customers purchase product in this market allows me to get a better understanding of the size of the business that we do in this country. Secondly it is important to highlight the pricing level. We have products that are sold that are the same products through our channel. So we seek to provide on our website the pricing that is in line with that that shown in the Australian market.

Mr HUSIC: I am more than happy for you to correct me on this. From your earlier responses to my questions it is very hard for me to see how your programs are personalised or contextualised for the Australian market. They are effectively the same product and they are not really much different. So I do not know why Australian consumers are charged over \$1,000 more for your product here when there does not seem to be much localisation.

The other point, and I would like you to respond to both points, is: you are a global company with regional fiefdoms, if I can put it that way—that is, you seek to access markets globally but you do not allow customers to benefit from that global reach. If I want to go to adobe.com and purchase your product, you will not let me purchase it because you geo-blocked me from doing it. So I cannot get the benefit of the saving, but you get the benefit of the market. How is that fair?

Mr Robson: On the first part of that question, with relation to relevance and personalisation, the personalisation was not of the product; it was the experience when online. The experience when in front of a website that provides local content and information was the comment I was making with relation to relevance here; it was not with relation to the actual product itself.

Mr HUSIC: Excuse me for interrupting. What is the local experience, then, that people are obtaining? What is the benefit of it?

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

Mr STEPHEN JONES: Chat sites and blog sites?

Mr Robson: Exactly, yes, user communities where—

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

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

Mr HUSIC: But you do not localise that. I have been on about this and you guys have really valued my comments on this. When I have chase up your corporate social responsibility—what you do for Australia based on your local operations—I get redirected to the adobe.com corporate social responsibility effort and I find out what you are doing in America to help the local community groups and not in Australia. With people paying \$1,000 or \$1,5000 more for the localised product that we get through adobe.com.au, how come you cannot update your website to reflect what you are doing in Australia?

Mr Robson: We thank you for the interest that you took in our corporate social responsibility locally. Since that discussion, you will note that we have updated our website to talk about the fact that we provide local corporate social responsibility—

Mr HUSIC: Touche, Mr Robson, you did well!

Mr Robson: I will take the opportunity to mention that part of that is the provision of a scholarship at the University of Technology, Sydney. We work with a scholarship at the New South Wales Premier's scholarship awards and our staff obviously take very significant interest in local charities and we provide significant effort to do so.

Mr HUSIC: Coming back to that point about the differences, you mentioned before that you have to cover development costs. Don't you smooth out the development costs in bringing in new product, new software, globally? Or are you saying that some places pay more for recouping that development cost?

Mr Robson: Pricing is a highly complex environment. If you go through the hundreds of products that we have in this marketplace, some are more expensive than seen in other markets and some are less expensive. One example is one of our highest-selling items, Creative Suite master collections for students and teachers, which is 24 per cent cheaper in this market than is found in the United States. We have a different pricing around many of our products.

At an organisational level, it is very important to highlight that one of the requirements for us to remain successful and relevant is to drive innovation and to lead the market. In many cases, we bring to market technology that we do not know whether or not it is going to be successful. That is a very risky proposition. In high-tech we lead the market. We bring to market products and technology that have not been seen before. One of the most recent examples of that is Creative Cloud. We firmly believe as a corporate strategy that our customers will get better value in accessing our Cloud based offering. The pricing of that Cloud based offering is in line with the pricing that you see in the United States.

Mr HUSIC: For a lot of customers, if they buy Creative Suite, they pay Adobe once and can use that same software for years. Products like, for example, Photoshop do not go out of date that quickly and you can use them for quite some time. If you sign up for Creative Cloud, you are paying Adobe month in, month out. So consumers are making a choice. I put it to you: (1) I think consumers would prefer being able to buy software once and be able to have it and use it for years instead of going online and (2) why is it that you are able to reduce the price of Cloud and not your other products?

Mr Robson: To your first question, overwhelmingly we are finding customers are choosing Creative Cloud over perpetual product licensing. So 76 per cent of our customers are now purchasing Creative Cloud instead of the traditional perpetual licensing model. There are a couple of specific reasons that they do that. The first one is that Creative Cloud provides access to continual updates, enhancements and new features of our technology over time. An example of that would be that if you bought a copy of Photoshop prior to there being a new operating system in the marketplace or prior to there being a new piece of hardware, such as a tablet or a smartphone, the technology that you purchased would support the technology that was available in the market at that point in time. It is a snapshot of the tech landscape. But by being able to provide a Creative Cloud offering it allows us to then provide enhancements and updates to customers throughout all innovation across the technology landscape. So as other vendors bring hardware or new operating systems to the market our customers get recurring updates and enhancements to our technology. If you were to buy a box product or perpetual licensing product you would be effectively locked into that product and the technology that existed in that box when you bought it.

Mr HUSIC: But even then you would have updates. Most software provides for updates. You might buy it in a box and load it up on your system but then it will be updated through the course of time. Are you saying that that does not happen with in-the-box products versus cloud products?

Mr Robson: It was brought to market regularly as an update package, and that package was delivered to the market at a cost. So as a customer you could purchase an upgrade to our technology at a box product level. So if you were a perpetual customer for Adobe and you wished to stay up with the most relevant or the most current piece of technology you would pay an ongoing upgrade fee over time to remain current.

Mr NEVILLE: At your own timing or at the company's timing? Do you have to sign up to take the upgrades as they come online or can you just choose them selectively over time?

Mr Robson: That decision was based on the customer's desire to upgrade or not to upgrade. Our customers—

Mr NEVILLE: No, you are missing my point. When the customer buys that deal, are they required to take the updates as they become available or can the customer selectively take an update from time to time as it suits them?

Mr Robson: The latter.

Mr NEVILLE: I have just one other question on this. I am sorry to cut in. Does the Creative Cloud not require any purchase of a program prior to that? Once you buy the Creative Cloud can you get all the packages within that or are they segmented within it?

Mr Robson: If you purchase Creative Cloud you get access to everything within the Creative Cloud.

Mr NEVILLE: Every product that is within Creative Cloud?

Mr Robson: That is correct. If you are upgrading from an existing perpetual product you can purchase the Creative Cloud at a reduced price because that was considered to be part of our upgrade strategy.

Mr NEVILLE: Are all your software packages in Creative Cloud?

Mr Robson: We have a lot of products in our digital media—

Mr NEVILLE: But the mainstream software products—

Mr Robson: Yes. In fact, there are more products available in Creative Cloud. We add features to Creative Cloud that we technically could not offer otherwise. Some features exist in Creative Cloud that you would not get access to if you were to buy a box product, including collaborative services that allow you and I, for instance, to share files and information. It allows us to provide storage to our customers. It allows online storage. It allows them to easily share that content with other parties. It also allows them to synch across multiple devices. That is part of what we do. We innovate and bring to market new technologies.

Mr NEVILLE: Does that extend to music and video iPod access?

Mr Robson: We do not sell music, songs or video.

Mr NEVILLE: You do not have any connection with music at all?

Mr Robson: We provide technology that allows you to edit videos and edit photos, but we do not resell music in the way of other vendors that you have spoken to today. That is not what we do.

Mr HUSIC: Twitter is heating up as you are providing this submission today. I want to put to you some comments from people. One is that there are no coding changes for a US software product in Australia. There are no language changes, and the costs of development is the same. It is clear what they are saying is that there is not much personalisation of the product. I come back to the point: are we paying more for your software here in this country because of the localised experience that you are talking about on the adobe.com site? Are we really paying that much more for that service?

Mr Robson: It is important to go back and provide clarity around that statement. To be very clear: the comment that I made with relation to personalisation was about the experience that a customer has when on our website. It is not related to the product. They are two very different things.

Mr HUSIC: Or the price?

Mr Robson: What I was talking about with relation to what we call automatic redirection to adobe.com.au is to provide access to information that is relevant to the local market. It is not with relation to the technology.

Mr HUSIC: How long have you been in your position?

Mr Robson: Since November of 2011.

Mr HUSIC: Okay. From your predecessors would you have been aware of the level of discontent directed towards Adobe over its pricing here in Australia?

Mr Robson: Certainly we track our customers' feedback very closely. We are very interested in the feedback, both good and bad, that we get from our customers. I can attest that I meet with customers and partners every single day and I hear amazing stories about what organisations do with our technology.

Mr HUSIC: Adobe's technology is absolutely amazing, and that is why you are a market leader, but the point is: why can't Adobe's officers here in Australia stick up for Australian consumers and get a better price through your internal channels? I will rephrase that: not a better price; a fairer price.

Mr Robson: If I refer to the market-leading technology in terms of innovation that we have released into this market and other markets around the world, Creative Cloud represents for us the most significant technological evolution of the way that we deliver our technology. The pricing of that technology is, broadly speaking, in line with the price that you pay for that technology in the United States. The price of Creative Cloud in this country is \$49.99 per month.

Mr HUSIC: Admittedly, that is one product that Adobe offers.

Mr Robson: It is the suite of our entire technology.

Mr STEPHEN JONES: Are all apps available?

Mr Robson: All of them and more. This is back to Mr Neville's question. We have a lot of products, so it is inaccurate for me to state that all of our technology is in Creative Cloud; but, if you take our box product that was Creative Suite, which had the majority of our technology, Creative Cloud is that plus more. There are two applications—Muse and Edge—that provide different technology. There is sharing, syncing et cetera.

Mr SYMON: I am struggling with some of the answers that you have given to Mr Husic's line of questioning, so I may try a different approach. I am looking at a website of Adobe that tells me that Creative Suite today for full purchase is \$1,974 in Australia. I take what you have said about Creative Cloud being \$49.99 a month and that 76 per cent of your customers now sign up for Creative Cloud. Is the setting up of Creative Cloud an admission that your box pricing is too high? Do your customers, by their take-up, see it that way?

Mr Robson: I also refer to the fact that that same product is available for students and teachers in this market at 24 per cent lower than the cost of that same product in the United States. With relation to Creative Cloud, it is a stated strategy—you may well have seen our CEO this week announce it in our quarterly results—that we would like our customers to move to our new, innovative technology. In the same way that, in the past, IT vendors have moved their customers from floppy discs to CD-ROMs and from CD-ROMs to DVDs, we see benefit and an absolute value in providing cloud based technology to this marketplace, and our customers are responding to that.

Mr SYMON: On the same subject: the American price of that same Creative Suite 6 in 2012 was US\$1,289 around June last year. The Australian price at the time was \$1,798—a 37 per cent difference. The problem I have with that is, as you have explained, there is a local, personalised, relevant delivery to customers with those customers going to the website, but it is a website. Where are the hundreds of dollars of value in going to this website?

Mr Robson: Again I need to clarify that the personalised experience is with relation to the geo-blocking discussion around why it is that we redirect our customers to a specific page relevant to Australia. It is not related to the delivery of our technology.

Mr SYMON: But surely the reason you are redirecting them through geo-blocking is to make more money.

Mr Robson: The reason that we redirect them from an adobe.com site is to provide them access to the adobe.com.au information and activity. Customers can choose to purchase our technology through retailers and through partners. They set their own pricing. They can choose to purchase it directly from us.

Mr SYMON: But customers cannot choose to buy your technology cheaper from overseas to use here.

Mr Robson: Yes, they can.

Mr SYMON: They can choose to go to America and buy it from local American businesses. They can choose to import it from local American partners.

Mr HUSIC: Can I buy it off the internet?

Mr SYMON: But they cannot download it for that price. They have to go to America to buy it from a shop to bring it back.

Mr Robson: If they wish to download it, they have access to Creative Cloud, which is significantly cheaper as a value proposition.

Mr SYMON: To continue with Creative Cloud: in the US you have Creative Cloud as well. You said the price is similar?

Mr Robson: For Creative Cloud?

Mr SYMON: Yes.

Mr Robson: Correct.

Mr SYMON: What is the take-up of Creative Cloud in the US? You have mentioned 76 per cent of customers.

Mr Robson: As a percentage of the market I do not know that detail. There was a public statement made by our CEO this week with relation to the number of users that we have on that platform. I do not know the number off the top of my head. It did exceed the expectations that the organisation provided to the street.

Mr SYMON: Is that figure something you would be able to provide the committee at a later time?

Mr Robson: I can take that on notice and check, yes.

Mr SYMON: Thank you.

Mr NEVILLE: Are you familiar with the recent ruling by the US Supreme Court on 19 March regarding copyright.

Mr Robson: No, sorry.

Mr NEVILLE: In that decision on *Kirtsaeng v. John Wiley & Sons, Inc.* the court found that, when you purchase a copyrighted product, that copyright does not prevent the resale of that product to someone else and that the copyright owner cannot exercise his copyright to the second and subsequent person. There is an interesting parallel there, isn't there, that, if I buy an Adobe product in Canada, the US or the UK, I should be able to use it. The principle the Supreme Court used is, as I understand it, if you bought it, you own it and have the right to sell it. You might extend that, might you not, to say, if you bought it and you own it, you have the right to use it. What gives you—or any other company, for that matter—the right to stop me buying a product that I want to buy in Canada, the US or Great Britain in Australia? If you have a universal product, as Mr Husic was saying earlier, you operate freely in the international market, but then you put restrictions on your own products by segmenting the market. Do you think that that is fair?

Mr Robson: I am not a lawyer and I am certainly not versed in the US Supreme Court and its decisions on matters, so I do not think I should comment on any of those; but, with relation to your question on products being purchased in other regions around the world, I think there are two facets to that discussion. The first one is that you can purchase our technology in other countries and use it in this country. If you purchase our technology in the United States, we are not obligated to provide a warranty for that service in this country, so one of the reasons we prefer our customers to purchase locally is so we can comply with local regulations in this country. The second is that, for example, I run a local operation. That operation has costs. Those costs include the salaries of our staff, the leases on our buildings, the investments that are required to develop our channel and our routes to market, and the ongoing requirements for our partners to make their own return in terms of paying back their costs and making their own profit margins.

The costs of running a business vary greatly in all markets around the world with traditional technology that is in a physical format. You heard earlier today that there are costs associated with freight, shipment, logistics, et cetera, of those products in the marketplace. For us, we direct our customers on adobe.com to a local that helps us provide back to the local market a local organisation that provides service support, a local sales and marketing effort and local content.

Mr NEVILLE: But, hardly at 50 per cent more.

Mr Robson: Again, I refer to one of our higher selling products, which is our complete suite of technology that we sell to students and teachers in this market, which is 24 per cent cheaper in this country.

Mr NEVILLE: I was just coming to that. I am equally bewildered by the fact that you charge so much for some products and so little for others, if your argument is about cost and freight and operating in the Australian market as distinct from others. If that is a constant, how in heavens name can you take your educational material to market at 17 and 21 per cent under the going rate for a comparable product? What that says to me is that, if with the rest of your products you are charging on average about 50 per cent more and then you can come down to charging 20 per cent less, you must have a pretty hefty profit margin of around 70 per cent floating around in that equation. Why would you sell to Australian schools, on average, about 20 per cent less than you would in the States?

Mr Robson: That offer sells to students, not to schools. We have a different licensing program that sells to government departments and educational facilities. We have a licensing program. The pricing discussion that I think you are referring to here is the product that is sold to individuals and not to organisations or entities. It is the student and teacher edition.

CHAIR: You are offering discounts to students, and you are sort of giving that to the committee as evidence of lower pricing strategy and that there are swings and roundabouts. One of the things that has been put to the committee in the past is that companies—and this is quite understandable—want to capture a customer and an IT ecosystem. Of course, once you are in it, by definition you are a price taker, I suppose, rather than a price maker.

Aren't your discounts to students part of an understandable marketing strategy to get them to use your products when they are in the university and, when they graduate, presumably, go off into the business world?

Mr Robson: When you look at the way that we want our innovation and our technology to be used in the marketplace, we have a stated corporate objective that we would like to change the world through digital experiences. That is what we do. We are an innovative, high-tech organisation that invests to bring to market technology that enables people to do things with digital experiences and move the economy towards digitisation. One of the many ways we do that is that we have different marketing and sales efforts to different market segments. That is just running a business. We run a business that focuses on all different market segments including, as we mentioned in my opening statement, that there are different pricing methodologies in place for government departments, for large corporations and for not-for-profit organisations as well as for students, end users and small businesses. It is a highly complex environment that we run a business across all market segments.

Mr NEVILLE: Coming back to that, the chair has anticipated my question somewhat. You call them 'student editions', the ones that are selling at 17 and 21 per cent cheaper in Australia than in the States, so presumably they are aimed, if not at school students, or university students, or TAFE students or whatever. Why would you do that? Is it that you think Australian students are a bit dumber than the other kids around the world? Do you have a philanthropic need to help Australian students? Or is it that you want to infiltrate that market so that further down the track you can sell to those students a wider range of your products?

Mr Robson: As a beneficiary of the education system in this country, and given the fact that I have many friends in positions around the world, I can attest to the fact that the education system here is very good and very strong, and I would not agree with your first statement, not at all. With relation to the second part of your question, we—

Mr NEVILLE: By the way, to be fair to you, I did not mean 'you' personally, I meant 'you' the company. I am sure your masters have a big hand in these decisions, not you personally. Let me make myself clear on that point.

Mr Robson: That is understood. I would like to reiterate that the future of the way that we will deliver our technology is via a Creative Cloud based system. Creative Cloud also has a different price for students and teachers. Our Creative Cloud pricing for students and teachers is \$24.99 a month. We have currently got a special on that technology at \$14.99 a month, and let me refer to the reasons and the rationale behind why we would have that special. Part of the reason for that is that we are actively encouraging our customers to take up this new technology, and we do that because we believe it is a better way for our customers to get access to the way that we want to bring to market our evolution of innovation.

Mr NEVILLE: So it is the second proposition that I put you. You were trying to position yourself to take a segment of that market.

Mr Robson: We are definitely trying to position Creative Cloud as the future of the way that we deliver our technology.

Mr NEVILLE: Do you see these student packages are the way to get there?

Mr Robson: It depends on the segment. For students and teachers, we have great support from that market vertical. Students and teachers are very heavy users of our technology. If I take as an example the New South Wales education department, some years ago when there was a government initiative to provide a computer in school for every student over year 9, we worked with the department to provide our applications on those computers to better enable students to learn and become more competitive on a global scale.

Mr NEVILLE: All I can say is there must be a huge flexibility in your prices if you have got some products that sit, as I said before, at over 50 per cent in Australia of the US market, and in other areas you can afford to go to 20 per cent less. That brings me to my next question. Are you saying that you have no music products, or video products either, in your suite of sales?

Mr Robson: We have technology that allows you to create and edit video and music, but we do not resell videos and music.

Mr NEVILLE: You do not resell either videos or music.

Mr Robson: That is my understanding, absolutely.

Mr NEVILLE: Did you hear the evidence given by Apple?

Mr Robson: This morning, yes, I did.

Mr NEVILLE: Their argument is that the owners or the distributors of the music, as the wholesalers, largely control the Australian market—or the extent to which the Australian market varies from the US, Canadian and UK markets—because of the prices they charge in Australia. In your case, there is no music or video involved, so

we assume that most of yours, with the exception of the cloud, which you have explained very well, is either hardware or software. Is that right?

Mr Robson: We do not create hardware products. We are a software company. We only create software.

Mr NEVILLE: Why then is your software about 50 per cent dearer here than it is in the States? Apple could craft an argument for music and video, but they did not attempt to craft an argument for their hardware and software. Our secretariat has done a graph of the various players, and Amazon and Apple are far and away the lowest in average difference between the US and Australian markets. Adobe is certainly not one of the highest ones, but it is in the mix. One can assume that if Apple, notwithstanding the constraints placed on them in their music and video fields, can be one of the lowest variations of any company in Australia, why should Adobe—which is not tied down by the music or the video—have its software products that much more expensive? How is it that one company can get its software, and hardware products for that matter, into our stores, schools, government departments and so on, whereas your software products are on average around 50 per cent dearer. What is the reason for that?

Mr Robson: I cannot comment on another company's go-to-market model, its cost or profit model or its revenue model. I simply do not have that information.

Mr NEVILLE: The whole purpose of this inquiry is to find out why Australians are paying appreciably more for these products than people in other countries. Our standard of living, our economies, our educational systems—we are perhaps a little more remote in the world in terms of freight, but other than that—bear great similarity to New Zealand, Canada, the US, the UK and many European countries. Yet we pay 50 per cent more than the US market.

Mr Robson: Again, I will refer back to the fact that we have multiple products that are cheaper than they are in the United States. As well as that, the most advanced piece of technology that we have ever brought to market is Creative Cloud, and the way that we deliver that technology and the value that our customers are seeing in that technology is shown by the number of our customers who are moving there very quickly. And that product is priced—broadly speaking, because pricing is not a point in time and exchange rates fluctuate—in real dollar terms at \$49.99, which is in line with the pricing charged in the United States and in other markets.

Mr NEVILLE: I do not think that makes your case. I do not think that justifies your case at all. In fact, it makes the comparison even more stark. The components of Cloud—and all due credit to you—that you have concocted and worked into this Cloud package are the same components that would be in your software packages that you are selling, albeit that you have an automatic update component of that. How is it that you can do that internationally for roughly the same price between the US and Australia and yet you cannot do it on the software that goes into that Cloud package?

Mr Robson: The software is the same, the delivery mechanism is different. The Creative Cloud does not require the media to be created or the box to be built from cardboard, wrapped in plastic, put on a pallet, put on some form of transportation, shipped to the country and shipped out to retail partners that require bricks and mortar, staff and training to then sell it on to end customers. There is a cost associated with traditional boxed product that you simply do not have when you deliver products and technology via the Cloud.

Mr NEVILLE: You think 50 per cent represents a fair representation of that?

Mr Robson: I think that value and perception of the offering is clear in the take-up of Creative Cloud. It is probably worthwhile highlighting that I do not have visibility of the profitability of the different Adobe products in offices around the world. What I do know, and what I have been told, is that our contribution is very much in line with the other markets around the world.

But, again, when you look at Creative Cloud, the delivery mechanism is the key piece here. The for that reason strategically is that it adds value for the customer in that the customer gets a continual stream of updates and enhancements. When vendors such as the one you spoke to this morning bring out new hardware we have to support that hardware. Customers want the ability to use our technology or our application layer on top of those devices. We have to therefore invest a lot of R&D, effort and money in delivering those updates. In the past those updates were made available through upgrade packs that customers purchased. Those updates now come to you automatically as part of the cloud offering and as fast as we can bring them to market. So the value to the customer is different. The market is changing. In high-tech it is very hard to take a snapshot in time and ask, 'All things being equal, does this all makes sense?' The market is constantly evolving as innovation is being brought to market.

Mr NEVILLE: When you sell a Creative Cloud product or package, do you pay GST on that?

Mr Robson: Let me take that on notice because I am not actually familiar with whether or not the price includes GST. It complies with all of the regulations with relation to the ATO.

Mr NEVILLE: What is your structure in Australia? Are you a wholly owned subsidiary of Adobe internationally?

Mr Robson: Yes.

Mr NEVILLE: Does your head office charge you a wholesale figure for the use of Creative Cloud?

Mr Robson: Again, similar to the explanation given earlier today, we have a highly detailed engagement with relation to the import costs with which we do business and the costs which we incur locally to run our business. Software is different to hardware because it is a very different model.

Mr NEVILLE: I understand that.

Mr Robson: There is a cost associated with the software that we bring into this market and the price with which we move those products around.

Mr NEVILLE: You understand why I am asking the question. The amorphous nature and newness of the whole cloud concept of recent years and your particular variant on it, your Creative Cloud, means it would be a great vehicle, would it not, for cost shifting where you set your retail and wholesale price for your Australian consumers?

Mr Robson: I am not sure I understand that question.

Mr NEVILLE: For example, if you were to charge a wholesale price of 60 per cent of its real cost to your Australian subsidiary and then you sell that, there is notionally a 40 per cent profit on which you would pay tax and various other things to ATO. If, however, the wholesale price was costed at 80 per cent of the real cost then there would be a lower profit margin in the Australian company's books but a much higher one in the American company's books. I am just interested to know how you differentiate between the American market and the Australian market in how much of Creative Cloud is represented in the cost to the Australian consumer.

Mr Robson: I do not have visibility on the different cost structures for different markets around the world for technology.

Mr NEVILLE: Do you set the price in Australia or does the American parent set the price for Australia?

Mr Robson: We are given a cost price. That cost price, to your point before, includes the cost of creating that, R&D et cetera. Then what we do locally is we build our business based on that cost price.

Mr NEVILLE: How does that appear in your books? Does that appear in your books as a direct transfer to the American company or does it appear in your books as a wholesale and retail component?

Mr Robson: I am sure it appears in our books in a way that complies with the Australian taxation requirements. I am not familiar with exactly how that is listed.

Mr NEVILLE: Could you come back to us on that, please.

Mr Robson: I will take that on notice.

Mr NEVILLE: Thank you, Chair.

Mr STEPHEN JONES: I want to ask a couple of questions first about your Photoshop product—it is one of the ones I am most familiar with. Do you make money out of the student edition in Australia?

Mr Robson: I consider that company confidential information with relation to the profitability of a specific product.

Mr STEPHEN JONES: It is kind of a yes or no answer. I am not asking you how much; I am just asking whether you make money from selling the student edition.

Mr Robson: Again, I consider that to be company confidential information.

Mr STEPHEN JONES: It actually goes to the heart of the inquiry. We are inquiring about the prices you charge people here in Australia versus overseas. You have held up the student edition as your beacon for why Adobe does well in Australia. You said that you are putting that onto the market in Australia at something like 24 per cent—my figures say 21 per cent—less than what you can buy the normal edition for in Australia. Surely it is relevant to any recommendations that we might make for us to know whether a business can do that and still make money on that product line.

Mr Robson: I do not think it is accurate to pull one product out of a price list that contains hundreds of products and talk about the individual profitability of one single edition.

Mr NEVILLE: Okay, but you highlighted it. We did not highlight it to you; you highlighted it to us.

Mr Robson: I highlighted student and teacher pricing across multiple products. There is not just one product. We have tens of products that fall under that category.

Mr STEPHEN JONES: But you can understand our concern, can't you? We set up this inquiry on the well-founded apprehension that our people in Australia are paying more for their IT products, through companies like yours and others, than they would pay if they were purchasing those same products overseas. You come to the inquiry saying: 'Hang on, you've got that wrong. Check out this product here, the Photoshop CS6 Student Edition, where you are paying 24 per cent less here in Australia than you would be in the United States.' We are entitled to ask you, with the greatest respect, Mr Robson, whether you are doing that on a commercial basis or not.

Mr Robson: If you look at Photoshop, it is also available as a cloud based offering at pricing that is in line with the pricing for that same offering in the United States.

Mr SYMON: When does that student discount price end?

Mr Robson: For?

Mr SYMON: For what we are talking about here—Photoshop.

Mr STEPHEN JONES: We are talking about the student edition.

Mr SYMON: CS6?

Mr STEPHEN JONES: Yes, CS6.

Mr Robson: There is a current promotional price in the market for the student and teacher edition of Creative Cloud. It would not be right for me to share our marketing strategies with you in an open forum and provide my competitors with access to information in relation to our go-to-market and when we will or will not be offering specials in the marketplace.

Mr HUSIC: I think your site says it finishes on 11 April this year.

Mr Robson: There you go.

Mr STEPHEN JONES: On the basis of what you have told us and what you are not willing to tell us, the only thing the committee can do is treat as completely irrelevant any submissions you make in relation to the Photoshop student edition, because you are unwilling to tell us whether or not you are providing that to the market on a commercial basis. I am not asking you to disclose your margins. I am not asking you to disclose how much money you make out of every box. I am just asking whether this is a commercial arrangement or not.

Mr Robson: Again, you are looking at one product in a price list that contains literally hundreds of products.

Mr STEPHEN JONES: I would not be looking at this product had you not highlighted it.

Mr Robson: Again, I highlighted student and teacher editions, which is a category that contains multiple products, not just one.

Mr STEPHEN JONES: Is the box that the student edition comes in materially different from the box that the normal edition, the non-student edition, comes in?

Mr Robson: It very clearly states that it is a student and teacher edition on the front.

Mr STEPHEN JONES: Apart from 'student edition', is there any difference to the box?

Mr Robson: There is the buying criterion that you need to make a submission that proves that you are actually currently a student or a teacher in this marketplace.

Mr STEPHEN JONES: Is there a piece of paper in there or a box to tick somewhere?

Mr Robson: That happens through different mechanisms.

Mr STEPHEN JONES: At the point of sale?

Mr Robson: At the point of sale.

Mr STEPHEN JONES: Okay. But, apart from the bold print 'student edition' and a piece of paper in there or a piece of paper on the desk of the retailer, there is no material difference in the box between the student edition and the normal edition?

Mr Robson: I would consider a box that has different writing on it to be materially different.

Mr STEPHEN JONES: In terms of you the company producing the student edition—sticking it in a box, putting it in a store like Harvey Norman or whatever the other retailer is—and sticking the grown-ups edition in a box and putting it on the shelf, there is no material difference between sticking both of those discs in a box and putting them on the shelves.

Mr Robson: The packaging and the information is materially different.

Mr STEPHEN JONES: Is it materially different from a cost point of view?

Mr Robson: I am not following that.

Mr STEPHEN JONES: Let me be blunt: is there any price justification on the basis of the box that you put the disk in for charging an enormous difference between the student edition and the other? I am trying to remove all of the reasons that you have given us for the massive differences in pricing. You say 'putting a product in a box and putting it on the shelves'. I see two products here. For one of them we pay 49 per cent more than the American consumer and for one of them we pay 21 per cent less than the American consumer. I am trying to work out what the justification for that is, assuming that you provide both of them on a commercial basis. Is the box different?

Mr Robson: There are many other products on the price list that, again, have varying percentages of cost in comparison to other markets. I think that the question is more in relation to the technology inside the box than the box itself. The box itself is materially different. The technology inside is similar. I refer to the comments made by Treasury in Geoff Francis' submission, where he spoke about the fact that there are benefits to society where organisations provide discounts, in the same way that the technology that we provide to government departments or large corporations that purchase on volume is not materially different.

Mr STEPHEN JONES: I am trying to get to the nub of the issue, which is why there might be an enormous difference in what a consumer might pay for a product here and product in the United States. When I look at two products which are very similar to put on the market, I see that Photoshop student edition is 24 per cent less and Photoshop for grown-ups edition is 41 per cent more. If it is not the box, why is there a massive difference?

Mr Robson: There is probably a third product to add to that: Photoshop via the cloud, which is, broadly speaking, the same price.

Mr STEPHEN JONES: I am going to get to the cloud stuff. I have to say: I think your evidence on this point is evasive, so I will move on.

Mr NEVILLE: Before you go to your next point, I just want to ask the question you are asking, Mr Jones, in another way. You say you are selling this student edition group of products within your product range at between 17 and 24 per cent less than in the US. Is that an ongoing policy, or is it by way of a special?

Mr Robson: Our student and teacher pricing has been, generally speaking, at the levels that you are seeing today. We then have specials on those and other products at different times.

Mr NEVILLE: That is a general policy. It is not just a 12-month special or something like that?

Mr Robson: Correct.

Mr STEPHEN JONES: I go to the issue that you raised in your opening submission, which is about cost recovery for the investment in intellectual property. I think it is an important submission, because if we are to have a sustainable IT industry in this country, or anywhere else, there needs to be a reasonable return for individual software developers from their intellectual efforts. I do respect that submission; I think it has some weight to it, but what I need to know is how Adobe, as a company, determines the proportion of that cost of intellectual product development between its various countries.

Mr Robson: That is highly complex. As the guy who runs one of many subsidiaries around the world, I do not have access to the visibility to a lot of that information. What I can say—and I do have access to visibility—is that, broadly speaking, the contribution that we provide is in line with the contribution that is provided by other markets and subsidiaries around the world.

Mr STEPHEN JONES: On the information available to me it appears that, if it is not the box and it is not cloud, we are paying more for our contribution to the intellectual property development in Australia than any other country in the world.

Mr Robson: I think I will go back to my opening submission, where I mentioned that cloud based technology is in-line with the pricing. For legacy technology that we were selling in a box, through a channel, there are costs associated with that—with the manufacture of the product, the box itself, the plastic that goes around that box, the putting it on a pallet, the transportation et cetera.

Mr STEPHEN JONES: I understand all of that. I am looking at all every one of those arguments you are raising—you are placing them on a pallet and stacking them up et cetera—and rattling those around a bit and saying, 'Is there any validity in it?' We have worked out that there is no material difference in the box between a student edition and a grown-up edition. I have thrown that argument away. I am not looking at the distribution between countries of how much it costs to develop the product. Are we paying a disproportionate amount in

Australia for that investment in intellectual property than we would be paying if we were in the US buying that product?

Mr Robson: I don't believe so.

Mr STEPHEN JONES: Okay. I have to say, Mr Robson, the evidence would tend to suggest otherwise. Do you have a—

Mr Robson: I would draw your attention to the pricing for Creative Cloud, which is broadly speaking, again, dollar-for-dollar in-line with the pricing we are seeing in the United States.

Mr STEPHEN JONES: I will go to the Creative Cloud. It is not true that all of your products are now available on Creative Cloud, is it?

Mr Robson: Again, we have a very large product portfolio. So the products, Master Collection or Creative Suite, and others are inside Creative Cloud.

Mr STEPHEN JONES: Adobe Lightroom, for example—that is not available on Creative Cloud, is it?

Mr Robson: It is available through a mechanism through Creative Cloud.

Mr STEPHEN JONES: But it is not a part of the standard subscription for Creative Cloud, is it?

Mr Robson: I don't know off the top of my head—because, again, there are multiple offerings of our cloud based service. It is a highly complex—

Mr STEPHEN JONES: And it is the job of this committee to try and wade through some of this complexity, to understand whether we are tilting at windmills or not.

Mr Robson: I understand.

Mr STEPHEN JONES: Can I ask about the cloud service. You are saying that 76 per cent of customers are going with the cloud services. Is this an administration by Adobe, and perhaps others, that the old business model is broken, that it is dying?

Mr Robson: No. I think this is a great example of us investing in innovation. I have spent 20-plus years in the IT industry. I remember when I started, I worked for a company that no longer exists—one of many that the IT industry has seen come and go, Compaq Computer Corporation. We had a product life-cycle of three months. We brought technology to market. That technology was obsolete very quickly. I lived through the introduction and evolution of the itanium processor, from floppy disks in multiple formats to CDs; from CDs to hard drives. I remember selling PCs in this market that did not have video cards or networking cards—they were options that you could add on. Technology evolves and, broadly speaking, the concept of the Creative Cloud is the next phase for us in terms of providing innovation.

Mr STEPHEN JONES: I get that. And you have made much of the fact that, if you are an Aussie, you can download something from Creative Cloud at the same price as you can if you are sitting in California. I think that is a positive development, and I am sure all members of this committee would see that as a positive development. I have, however, pointed out that there are many products that you still sell, that are highly sought after in the market—some may even say near essential in certain professions—that are not available through the Creative Cloud service, and that people are still paying more in this country than they would be paying elsewhere. Perhaps I could put you on notice about the one example I have raised—and others, if you would to provide subsequent evidence to this committee.

But I want to go back to the business model for a moment. Assuming the cloud service provides uniform pricing—and that is a big 'if'—and this is the future, and the old style we are looking at where you pay for a download is phasing out, if governments acted to limit or regulate geo-blocking, would this have a material impact on the future of your company?

Mr Robson: Sorry, I am not following the question. In relation to the future—

Mr STEPHEN JONES: Perhaps I won't load it up. I will just put it to you this way: this committee is very soon going to turn its mind to the remedies that might be available to limit or regulate what we see as unjustifiable geo-blocking and geo-pricing arrangements.

If 76 per cent of your customers are now going to the cloud based services, with uniform pricing—I presume the force of your evidence is that that is growing—then we could not hear any legitimate complaint from a company like Adobe if we were to move in the direction of regulating or limiting geo-blocking or geo-pricing technologies.

Mr Robson: I don't think it is my place to comment on legislative changes or what you do or do not decide to recommend. To the point that I think you made earlier, in relation to whether the technology is moving to the

point that we will move away from the legacy way of selling our software: absolutely, we are moving towards cloud based offerings and delivery of our technology.

CHAIR: I guess we could argue about the legacy issues—and you are clearly giving us an indication of your company's direction. For the future—you can take this on notice if you like—is the company giving Australian consumers a commitment that they are aware of this issue of IT price discrimination and the sorts of sentiments that it creates in the Australian consumer's mind? Are you giving a commitment today that you are going to eschew the price discrimination we have seen towards Australian consumers in the future?

Mr Robson: I think that, when we talk about our technology we talk about value, we talk about innovation and we talk about providing our customers a solution. As much as I would love to be in a position where I ran an organisation that had no alternative, there are alternative technologies with every single product that we sell. What we have to do is provide value and innovation, and that is what we do with the cloud. Our customers will do business with us if they are getting value from doing business with us.

Mr SYMON: I would like to keep talking about the Creative Cloud and the change of business model, because I think it is an interesting area in which there has been, as has been said, a lot of take-up. My concern with that is: what happens to a subscriber if they stop subscribing? In other words, all of their content that they have put on the Creative Cloud, some of which may only be accessible by using products that come with your Creative Cloud, are no longer available. So, they stop paying their bill, and Adobe quite rightly says, 'You're not paying us for the product; you're cut off.' What happens to a person or a business in that situation versus the old—as you call it 'legacy'—model of someone or a corporation owning a piece of software that then allows them to access their own creations and their own business forever, as long as their software continues to work in their machine of the day?

Mr Robson: It is not vastly different from what would have happened had an organisation in the past had access to technology, the creative content, that was for a device and that device changed and was upgraded, or the operating system changed, and that content could no longer be accessed on that device—they would need to upgrade their technology. That is IT. That is what happens in this space.

Mr SYMON: But isn't the difference there the access to what you have created? If I were to own a copy of Creative Suite 6, and I made various things I needed and kept it on my computer, that is fine—I can access that for as long as that operating system and that piece of software is there. Whereas, to me the question becomes: if it is a monthly subscription service and, for whatever reason, that is no longer continued, where does the content go?

Mr Robson: The content remains wherever you have left it. So if you store that content on your hard drive, that content is still there. The application is different from the file that you create. You need to have a difference between the two.

Mr SYMON: My question is: if you no longer subscribe to the cloud, where does the content that was on the cloud go?

Mr Robson: The cloud is highly complex, but the cloud is not where everything is kept. The cloud is a delivery mechanism. It is a mechanism for you to sync and share, it is a mechanism for you to share files. You download the application onto a hard drive and you can store your files on your own PCs, your own servers and your own storage devices. You do not store the data. You can store it in the cloud or you can store it locally.

Mr SYMON: My point is if the data is stored in the cloud and someone stops subscribing, where does the data go?

Mr Robson: I would imagine that you would have stored it locally at the same time.

Mr SYMON: You are still missing my question. If you have not continued your subscription, where does the data that resides in the Adobe server that is then put up onto the cloud go?

Mr Robson: I will take that on notice. I do not know.

Mr HUSIC: One person was saying—again, this was coming through on Twitter—that if someone is using Adobe Creative Cloud they are locked in it for life. You would lose your files when you stop paying. That was the statement that was made.

Mr Robson: That is an inaccurate statement.

Mr HUSIC: I want to quote some prices, all in Australian dollars, if I can: for Creative Suite 6 Master Collection, the US price is \$2,645 and the Australian price is \$4,035. For Photoshop CS6 Extended, the price is \$1,115 in the US and \$1,519 here. For Acrobat 10 Pro, the price is \$458 in the US, \$699.95 in Australia. It has been pointed out to me that the price today of the standard Adobe Acrobat Pro Version 11, online in Australian

dollars, is \$637, and \$471 in Singapore—there is no freight involved because it is a download—so it is 26 per cent cheaper in Singapore.

Here is the point I want to raise and the thing that has got me about this whole issue of IT, because a lot of people in IT are going, 'Why are you just picking on us?' You have actually mentioned that this is not just an issue affecting IT. Your opening submission pointed to the fact that this is an issue across the country. I have had people raise with me, for example, the costs of ride-on mowers, blenders and everything. My big focus has been this. Because so many people use your product and Microsoft products and other products, they factor that into their businesses here. Then you come along and say to us: 'The cost of doing business in Australia is part of the reason why we charge so much.' What I am asking is: do you accept responsibility that, as a big member of the IT sector, you are actually responsible for part of those costs and that you use that to justify that for why we are paying more?

Mr Robson: All the products that you made mention of have a physical box product equivalent that is sold through a distribution channel in this marketplace that has ongoing costs. The cloud-based delivery of those technologies has pricing in line with the pricing you see around the world.

Mr HUSIC: Do you accept that your pricing, along with those other big players in the sector, is adding to inflationary costs here in Australia? As I said, you can see the big differences here—they are not small.

Mr Robson: Again, all of those examples have an equivalent product that is put in a box, shipped, transported and sold through a retailer and reseller channel. For cloud-based technology the pricing is broadly speaking in line. Given that the pricing on that represents what both our customers and we believe is significant value, I would argue that the decision on whether or not we are adding value to the customer is there for the customer to make.

Mr HUSIC: Mr Robson, with respect to those differences—53 per cent differences on Creative Suite, 49 per cent on Photoshop, 53 per cent on Acrobat and 26 per cent, as I have quoted before, it cannot simply be because the product has been put in a box. You guys have known for some time—and that is why I asked you the question earlier about your predecessor knowing about the level of discontent about pricing. It has been reported so often that your prices are completely out of whack, compared to other markets where you are offering this product. Is it not simply a case you had a great run, you charged as much as you could and now you know that consumers are saying that we as a market are not prepared to bear these costs anymore?

Mr Robson: As well as those examples, there are many examples of our technology that exist at prices lower than those seen in other markets around the world, and we have spoken about some examples of those in relation to student and teacher editions. Again, I refer back to the fact that our stated strategy as an organisation is to deliver value and innovation to the marketplace. In a cloud based offering you remove a lot of the cost in relation to physically transacting it and moving around physical products in a local market. The pricing for our cloud based technology is broadly speaking in line with that in other countries around the world, and you can see from the statistic I mentioned in my opening statement that it is being very well taken up by our user base.

Mr STEPHEN JONES: With respect, you have said—I think it was in relation to Mr Symon's question—that you do not lose access to the files. But there is a digital handcuff, isn't there? The digital handcuff is this: you may be able to access the files, but you may not be able to open them or alter them unless you have the proprietary product. So, your cloud service is providing a digital handcuff and people must continue to subscribe if they want to continue to access their own property in any meaningful way.

Mr Robson: I am not sure of the question.

Mr STEPHEN JONES: In relation to an earlier question, where Mr Symon, I believe, asked you: can people still access documents they have created in the digital cloud if their subscription lapsed? You said yes—

Mr Robson: The answer is yes.

Mr STEPHEN JONES: But that is not totally true, because you might be able to access the file but you cannot open or alter it in any meaningful way if you do not have the proprietary product that created it in the first place. So there is a digital handcuff.

Mr Robson: And that is not vastly different from the entire history of the IT industry, where if you upgrade technology you lose the ability, in many cases, to access prior technology.

Mr STEPHEN JONES: Every version of Microsoft Word I have bought enables me to open a document that has been created in an earlier version of that software. And, by the way, if I have it on a disk—or in those days it was a floppy disk—I do not have to continually pay a subscription through the cloud based service. I have that, and I can always open those documents.

Mr NEVILLE: In answer to Mr Husic pointing out the variation in buying some of your products online, did I hear him say that it is 26 per cent dearer in Australia than it is in Singapore?

Mr HUSIC: Yes.

Mr NEVILLE: How can that be? I can understand that with boxed or hard-edged products it would be different, but why would it be dearer online when you are in the same part of the world?

Mr Robson: That product has an equivalent physical product.

CHAIR: Are you saying that it costs more to ship to Australia than Singapore, or that the costs in Singapore are lower?

Mr Robson: Our physical boxed product is created in Singapore. It is a very small country. When we sell that product in Australia—going back to the prior discussion—we need to move it around and put it on pallets. To your question, which I think is in relation to the electronic version of that, there is an exact equivalent of a physical product of it that is sold by our partners in a channel format. So the pricing generally is aligned to make sure that the partners can continue to run and operate a business in this country. Where there is not a product that is an exact equivalent, and that is the case for the cloud based product, the pricing is in line with that seen in other markets.

Mr NEVILLE: If as you say Singapore is a much small market I would have thought it would have been dearer in Singapore and not cheaper, whether it was in the boxed form or the electronic form.

Mr Robson: I think that is what Mr Husic said.

Mr NEVILLE: All right, I will not pursue it. The other thing I wanted to clarify concerns the cloud. Where someone has stopped paying the subscription, for whatever reason—it might be someone who is ageing and loses the will to be computer connected—and some years later that person dies and the family has need to extract some of that information, is there a way of buying back into the cloud to retrieve data?

Mr Robson: The data that is created by the technology delivered through the cloud is held on your own PC.

Mr HUSIC: I can clarify this, Mr Neville. The Adobe website states:

If you cancel your paid membership you will still have access to the free level of membership, which provides 2GB of storage. You will have a 90-day grace period to delete files to get your cloud storage down to 2GB (or to purchase additional storage separately if you choose). If you leave more than 2GB of files in your cloud storage for more than 90 days, you may lose access to some or all of your files.

Mr Robson: To add to that, you have the opportunity prior to that to have all of those files on your own hard drive or storage devices.

Mr STEPHEN JONES: But the point is that you cannot open them.

Mr HUSIC: If you do not have the software, right?

Mr NEVILLE: Let me cite you an extreme case. Some very adept crook has been getting away with fraud for a long time and the data is recorded on the cloud but not on a hard drive or on his computer. If the police have a need two or three years down the track to retrieve that information, is it available?

Mr Robson: Creative Cloud has been on the market since April of last year. I will take that question on notice and come back to you. It is a hypothetical discussion.

Mr NEVILLE: You have an Australian recommended price list, presumably?

Mr Robson: We have prices on our website that we sell to. We do not, as the other vendor who spoke this morning said, tell our partners what price they can sell for.

Mr NEVILLE: No, but a recommended retail price does not tell someone what they are going to sell at, just that it is a benchmark price.

Mr Robson: We have a price on our website for products.

Mr NEVILLE: And you do that in all countries?

Mr Robson: I believe so, yes. Not all countries have a local operation.

Mr NEVILLE: Well, you would be able to supply us with your price lists for Australia, the US, Canada, the UK, South Africa, Singapore—the English-speaking countries?

Mr Robson: I can take that on notice.

Mr NEVILLE: But can you do it? Will you take it on notice that you can answer the question or take it on notice that you will supply it?

Mr Robson: The information that you can freely access on the internet we can obviously supply. I can take on notice any information other than that. We can check internally.

Mr NEVILLE: Alternatively, if that is not easy for you to do, if we provided you with a list of products could you give us equivalent prices across English-speaking countries?

Mr Robson: That Adobe sells it for if we have an operation selling it online?

Mr NEVILLE: Yes.

Mr Robson: I can take that on notice.

Mr NEVILLE: Can you get back to us on that?

Mr Robson: Okay.

Mr NEVILLE: We may wish to put that in our report.

Mr HUSIC: As has been indicated before, the committee is looking at the whole notion of geo-blocking. If we recommend as a committee that we prevent you from geo-blocking to allow your customers to purchase your products direct from a US site, I would like to know what you think the impact of that would be. Secondly—I have had this matter raised—Adobe are apparently preventing Amazon and others from selling direct to Australia. You cannot ship Adobe product from Amazon US to Australia. Is that the case?

Mr Robson: On the second question, I do not know. I am not familiar with our relationship with partners in the US.

Mr HUSIC: Would you be able to take that on notice?

Mr Robson: I can take that on notice. In relation to the first question on geo-blocking I think that as representatives of the people of this country and in relation to running and governing the country you would need to take into account the impact that would have on organisations globally being willing to invest in the country and run a local operation employing staff and building an ecosystem that delivers inputs and adds value to the economy.

Mr HUSIC: I am asking the question to get your side.

Mr Robson: I think it is important to highlight that the IT sector is one of the biggest contributors to the GDP of this economy.

Mr HUSIC: Absolutely.

Mr Robson: We provide innovative technology. We bring to the market technology that helps develop and create jobs and provides the ability for small companies to build businesses, employ people and pay taxes.

Mr HUSIC: I have said elsewhere that you are the hidden pillar of the economy and you do not get enough credit for what you do. But at the same time it is a two-way street, and I think a lot of consumers feel that they are not getting the benefit of globalisation.

CHAIR: We might treat that as a comment! Thank you for your evidence. We have asked you to provide quite a bit of information to the committee on notice, so no doubt you will be in contact with the secretariat. You will be sent a copy of the transcript of your evidence. If there are any corrections of grammar or fact please let us know.

Proceedings suspended from 12:34 to 13:05

MARLOW, Ms Pip, Managing Director, Microsoft Australia

CHAIR: I welcome the representative from Microsoft to today's hearing. Although the committee does not require you to give evidence under oath, I should advise you that this hearing is a legal proceeding of the parliament and therefore has the same standing as proceedings of the House. We have received Microsoft's three written submissions to the inquiry, which are Nos 67, 67.1 and 67.2. Do you wish to make any further submissions or an opening statement?

Ms Marlow: I would like to make a brief opening statement. I would like to start by sharing our respect for both the parliamentary process and this committee in the inquiry. We are a global company, as you would be aware, and we have operated in Australia since 1983. We are exceedingly committed to our employees in Australia. We employ over 800 people across Australia and over 150 contingent staff. In addition to that, we support the Microsoft Partner Ecosystem, which is comprised of about 14,000 partners across the country. Those 14,000 partners employ approximately 84,000 Australians.

We are committed to contributing to the community in which we operate. We donated over \$40 million of free software to 2,700 not-for-profit charities across Australia last year. At Microsoft we are proud of our innovation. We invest over \$10 billion a year globally in R&D and, in recent times, have been transforming ourselves into a services and device organisation as we seek to embrace the future of business in the cloud.

Those three things—our people, our partners and our innovation—are really about aligning with our mission of helping people and businesses around the world to realise their potential. With that, I want to be respectful of your time and hand over to you to ask me any questions.

CHAIR: Thank you, Ms Marlow. I will put the same question to you that I put to Apple and to Adobe. We now have, because of the internet, the rise of what we might loosely call the 'global consumer'; and, while people might accept price discrimination from companies, I do not think they accept price discrimination on a geographical basis. I do not think they think that that is economically or ethically justifiable. I just wondered if you had any broad views about that.

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

CHAIR: Terrific. Mr Husic.

Mr HUSIC: There are a number of things that I wanted to cover off. What has been interesting in the course of this inquiry, Ms Marlow, is the number of comments and emails I have received. I just want to put to you an email, exactly as I received it. This person asked—and, obviously, this creates difficulties in itself—to remain anonymous. I got this the other week. It said, 'My business is a longstanding Australian Microsoft partner.'

Is that someone who is part of your channel process? Is that the label that is applied—you are a 'Microsoft partner'?

Ms Marlow: That could be a label that is applied, yes.

Mr HUSIC: Okay. I might come back to that if you could help clarify that for my understanding. The email continues:

I have partner only pricing sheets which will show you that the price we have to pay for identical Microsoft software is 50 per cent higher in Australia than in the US. This is downloaded software, same international version. There is no packaging, no freight, no support, no selling expense to my business and this has to be passed on to our SME customers. This represents an additional cost of approximately \$33,000 per month with growth approximately half a million over the next 12 months. Not only does this have a negative effect on the economy but it also stops my business and businesses like mine in Australia from competing on fair terms. I have learned not to ask Microsoft about this price difference. Frankly, they all know it is a joke but nothing will ever be done. I read Microsoft's late submissions to last year's inquiry and at least in respect of downloaded software their justifications are frankly rubbish.

These are his or her words, not mine.

How is it that the Microsoft partners feel that even they are being overcharged on product themselves which they feel they then have to pass on? If there are elements of what I have read out to you that you want to contest, by all means feel free to do so.

Ms Marlow: I certainly would not want to comment on a confidential communication between you and your constituent. What I would talk to you about are our model and how we work. As I mentioned, we do not operate

under a single global market model and there are a range of factors that do impact the way that we go into market. They may start with cost structure, customer perceptions, partner choices but most importantly the competition that we have in market.

I have been working at the company for 17 years and I would say it is the most competitive time for Microsoft that I have ever experienced. So ultimately our customers have choice and, at the end of the day, if we price our products too high our customers will vote with their wallets and we will see our sales decline. While there is competition in market and the customers have choice, we have to continue to deliver value. We have to innovate. That is why we spend \$10 billion a year on R&D to continue to build products to delight our customers.

Mr HUSIC: Do you make that R&D investment here in Australia?

Ms Marlow: The predominance of our R&D is international.

Mr HUSIC: I do not want to necessarily leave this email. I want to come back to it. But what you mean by customer perceptions?

Ms Marlow: The way our customer would look at valuing our product versus the product of our competition. So any revalue exchange for a transaction, be it IT or not, we all make decisions about the product that people are being delivered, the service that you get. Customers make decisions every day. I think the way we work is that we work to operate lawfully to compete every day for our customers' business.

Mr HUSIC: I think for Microsoft Office the claim was that you were charging over 76 per cent more for an Australian user of that product compared to the US. How do you believe the customer perception of that would be here in Australia and would that shape your pricing?

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

Mr HUSIC: So has Microsoft measured customer perceptions in relation to price differentials and whether or not they think that Microsoft's pricing is fair?

Ms Marlow: Not to my knowledge.

Mr HUSIC: I have been given figures of a suite of Microsoft products and these cover, for example, your open licence program. I can provide you with the printout of the products that it covers. This suite of Microsoft products in the US costs \$2,324. It costs Can\$3,105, it costs A\$4,136 and in Singapore it costs exactly the same to purchase as it does in the US. How would you imagine customer perception would be on those differentials, where there is an 86 per cent differential?

Ms Marlow: I could not comment on those figures because I do not have them and I am not sure of the methodology that was used. Potentially, you are going to this: do we have a price differential in our markets? The answer to that is, clearly, yes. We do not set a global price for our products.

Mr HUSIC: So it is unlike the other vendors that you heard today, where they set a uniform price. I understood that you did have a benchmark price that you apply and then there are variations in markets, depending on factors such as taxation, customs duties or whatever. You are saying that does not—

Ms Marlow: No, that is not how we operate. We do not operate on a standard price because we do not believe that every market is the same. We may be selling to an emerging market, for example, where the cost of living, the availability of technology, the ability of customer perception and the competition might be completely different. At the end of the day, we set our prices based on those factors. We do not set them on a global market. We know that, in the end, because we are living with competition, our customers will vote, as I said before, with their wallets. If we make the price too high in that particular market, they have choice and they will look elsewhere. We respond to that.

Mr HUSIC: I think in your submission you said that Microsoft's presence here is just sales and marketing. Is that correct?

Ms Marlow: We have an office here that looks after the marketing and support of our Australian customers.

Mr HUSIC: So you do not manufacture here. You indicated earlier that your R&D is conducted internationally.

Ms Marlow: Predominantly.

Mr HUSIC: Does that suggest that there is some R&D here?

Ms Marlow: We do have small amounts of R&D here.

Mr HUSIC: You would have to obtain product from Microsoft US—anything that you are planning to sell here: physical product and some limited hardware, but it is mainly software. Is that correct?

Ms Marlow: The majority of our business is software.

Mr HUSIC: That would be in either physical form or downloadable form—correct?

Ms Marlow: By physical, you mean—

Mr HUSIC: As in you buy a box—

Ms Marlow: In a box, in retail—yes.

Mr HUSIC: Those products have to be acquired, no doubt, with arrangements you make with the US—is that right?

Ms Marlow: No, that is not really how we work. If you can bear with me, I can explain a little bit of the model. First I will explain a little bit about the channel, because you mentioned open licensing. We work on a model where we have a channel and that channel is a little differentiated. As you would have seen in our submission, we talk about the volume reseller channel. They are our large-account resellers, value-added resellers. They sell our volume licensing, enterprise agreements, select agreements, open agreements. We would then have our OEM partners. That stands for original equipment manufacturer. If you are using a Toshiba, we would license our software to Toshiba to preinstall into the product. You would acquire the product through that. We have our retail areas. That would be something like Harvey Norman or JB Hi-Fi, through to a small, single-proprietary business who would sell what is known as retail product. That would be when you go into a retail outlet and see a box on the product. These days, we are not really using disks within that. Keys will allow you to download.

Mr HUSIC: Those multi-digits, like 16 digits that are hyphenated. I have seen those. I understand that you are able to download that. You are setting up transfer pricing arrangements with overseas arms of Microsoft—is that correct—so that you can get the product and make it available for Australian customers, but you are not manufacturing it here? You obviously have to get that from offshore and you have to set up prices for that initially. Is that correct?

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

Mr HUSIC: I was going to say you do not necessarily operate stores, but I think in the US you are rolling out your own retail outlets. Is that correct?

Ms Marlow: As in bricks-and-mortar stores?

Mr HUSIC: Yes.

Ms Marlow: We do not have any of those in this country.

Mr HUSIC: But you do in the United States?

Ms Marlow: Yes, we do in the US, and in Canada and Puerto Rico, I believe.

Mr HUSIC: So what you are doing here is you are relying, as you indicated, on the channel. You do not directly sell to the customer unless you have agreements with people such as Toshiba, for example, where you can pre-install and all that type of stuff. It is all done through the channel?

Ms Marlow: I am sorry?

Mr HUSIC: For your distribution of the product, do you basically have either retailers or the channel itself doing that?

Ms Marlow: The predominant measure of delivery to our end customers is through the channel. I mentioned in my opening statement that we have approximately 14,000 channel partners across Australia delivering different types of services to customers through all those different channels that I mentioned.

Mr HUSIC: In terms of the bottom line, your channel partners are saying in this email to me that the way Microsoft is setting that price is that it is being set at 50 per cent higher than what they could obtain in other markets. So before it even goes through the channel itself, the starting point is the price you set with the channel and then obviously it is marked up along the way, for understandable reasons. So why is that?

Ms Marlow: Just like I mentioned we do not have a global pricing model for the end customer, similarly with our channel. Just as we have to compete for the business of our customers, our channel partners will have a choice about whether they decide to partner with Microsoft or partner with another vendor. What we do is work to compete for our partners' business as well and make sure that we invest in them and work with them, so that when they are delivering and providing technology advice to their customers we hope that they see the value and delight in our product, as we do, and do that. At the end of the day they have a choice around the partners that they vendor with and we hope that the 14,000 that have chosen to partner with us feel that they are getting the value and support that they need from that in such a competitive marketplace.

Mr NEVILLE: You say that you do not price universally, that you do not accept the concept of a global pricing model. Is that right?

Ms Marlow: That is correct. We do not have a single global price.

Mr NEVILLE: Let me put it to you that the fact that you say you do not accept a global price does not absolve you from acting fairly in the market.

Ms Marlow: Correct. Microsoft, as I mentioned, are not selling into a single market and we are operating lawfully within the market to compete every day, because we have to delight our customers. Ultimately I think it is fair to allow companies—Microsoft and other companies—to compete lawfully for our customers' business.

Mr NEVILLE: You heard Mr Husic give you some pricing comparisons of US, Canada, Australia and Singapore. Singapore is in our part of the world, the Australasian area. You would imagine freight prices would be marginally the same. Singapore, if anything, unless there was a resell component there, would be a smaller market than Australia and yet the products in Singapore are exactly the same price as they are in the United States, but they are 60 or 70 per cent higher in Australia. How do you account for that?

Ms Marlow: I would say that we see, as per our submission, that there are a range of factors impacting the price.

Mr NEVILLE: Just go through a few of those for me again.

Ms Marlow: I would talk to the cost structure. As you would have heard earlier today, there are a number—

Mr NEVILLE: What cost structure precisely?

Ms Marlow: We would talk to things like labour costs, rental costs and compliance with local laws. But we are not saying that cost structures are the only part of things impacting our price. We are seeing that the law of supply and demand, customer perception, the value of our price and how we compete in the market are the things that we have to deliver on every day. We have to look at all of those factors and then make sure we are out there selling to a small business or a consumer, who has choices. In fact, we compete with products today that are free. So when the customer makes that choice we have to be able to deliver a product, should they choose us, that meets their value expectation.

Mr NEVILLE: Well, as I said to you before, the fact that you do not accept a global price does not absolve you from acting fairly in the marketplace. It seems to me that what you are putting to us is that you charge what you can get away with in any particular market.

Ms Marlow: We believe we are competing lawfully to win our customers' business every day. As I mentioned at the start, I have never seen such a competitive landscape in the IT market in my 17 years with Microsoft.

Mr HUSIC: What is your market penetration here? How many users of Microsoft products do you have in Australia?

CHAIR: I should add that if there is any commercially sensitive information we can go in camera, if you like, at the end of the session. So, do not feel obliged to reveal commercially sensitive information to the department.

Ms Marlow: Thank you, I appreciate that. The question is very broad. One part of our business is focused on server products. It might be about how we compete against Oracle in a database space. It might be about where we are on CRM against Salesforce, who has the largest market share in Australia. It might be how we compete against free software in the market. So, your question is so broad, because at different parts it would be exceedingly different, if you understand where I am coming from.

Mr NEVILLE: Here is what I find hard to explain, in this extraordinarily competitive market that you are talking about. We have done a price comparison, on big samples. For example, in your case we sampled 47 products, and we found that Amazon, for example, is about 15 per cent above the US price; Apple, about 18 per cent; and Adobe, 42 per cent. But Microsoft is nearly 66 per cent above the US price. Obviously we could not use exactly the same sample for each one, because they have different product ranges. But they were representative samples; 47 is a fair cross-section of product. If it is so highly competitive, how is it that your Australian price is between 60 and 70 per cent higher than your US price?

Ms Marlow: That is because there are a range of different factors that we will use to look our pricing model.

Mr NEVILLE: Surely not to that extent? For things like freight and labour costs, I know we have variations between the States and Australia, and some witnesses earlier today talked about sales taxes and GSTs. But when you take all those factors out it is pretty hard to concoct an argument for a 66 per cent difference, surely?

Ms Marlow: And I would repeat that I believe that we as a company should be able to compete for our customers' business, including different pricing strategies. I am not an expert on what you were looking at there, and the price differentials that you looked at. But today the estimated retail price in Australia for our premium offering for the consumer for Office—Office 365 home premium—is \$119 including GST, and in the US it is \$99 excluding GST. So, without looking through that, I would say that we have great products. We spend \$10 billion a year trying to build great products for our customers. We compete very much in every product segment and every customer segment that we serve. At the end of the day, when we put a price into market, if we price the product too high customers will vote with their wallets and move elsewhere. We have a very competitive landscape.

Mr NEVILLE: Let me put it to you another way. As well as looking to a sample range of products, we also segmented the electronic range of products. I am not comparing your product with music, but we looked at various other things. We found that in Australia we pay about 50 per cent more for software and about 46 per cent more for hardware, but in your case we are paying 66 per cent. Why are your products so much dearer than those of other companies, some of them of American derivation, in the Australian market?

Ms Marlow: I cannot speak for other companies' pricing.

Mr NEVILLE: You do not offer any justification other than that you do not accept an international model, you have the cost factors and you will charge what the market will stand?

Ms Marlow: In a market where there is supply and demand in a free economy, yes, absolutely. I would point to Treasury's own submission on this where they say:

Global markets are still developing, and the fact that consumers can access international markets directly is still a relatively new development from a historical perspective. Over time, it is likely that dynamic global product markets (noting particularly that the market for IT products is one of the most dynamic markets of all) will continue to develop, and consumer and business access to overseas markets will further increase, putting downward pressure on prices.

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

Mr NEVILLE: You are giving me a very nice company policy statement, but you are not advancing any arguments for how we get these excessive prices. Tell me: are any of your products encrypted or blocked so that they cannot be used in Australia if they are not purchased here?

Ms Marlow: We do use geoblocking as a lawful mechanism to manage our business, as some of our competitors and other companies do.

Mr NEVILLE: Why would you do that?

Ms Marlow: We use geoblocking in a number of different ways. We would use it to ensure we comply with local ratings for games. In different jurisdictions and geographies games will have different ratings, so we will make sure that we manage to that. We would use it to manage licencing arrangements on content, which differ from geography to geography. We would use it to make sure that we can adapt our business strategies, which might be different from geography to geography. And we would do it to understand what is happening in our own local geographies to make sure that we can make investment decisions to support the consumer demand in those different types of geographies.

Mr NEVILLE: Is there much difference between Australia and the US, Australia and Canada, or Australia and the UK, in terms of social development? Is there so much geographic difference between Australia and Singapore that we would have these variations of up to 66 per cent?

Ms Marlow: I am not an expert on those other economies to be able to comment on that. I would say that, in our market here, from consumer to small business, there is a great deal of competition. We price to the market that we are in, we look at the costs that we have, we look at customer perception, we look at our competitors, and we work very hard to make sure that we are building new and innovative products that customers see value in when they are making those decisions.

Mr NEVILLE: If your company policy is so crystal clear—and you have been over it about three times—why is it that you would not appear before the committee at an earlier date?

Ms Marlow: We chose to do written submissions and have ourselves represented by the industry body.

Mr NEVILLE: I could put this to you: a number of companies tried to get the industry body to represent them. So, when the committee approached the industry body and asked for the policies of various companies, the response we got was: 'We couldn't possibly talk about their policy.' Where did that leave us? That is just a convenient blocking mechanism between this committee and the information we were looking for. You must have known, as did one or two other companies that tried this trick, that you would refer us to the association and then, when we asked them a specific question, they would come back to us and say, 'We couldn't possibly answer that question. We can't speak for individual companies.' We are on an inquiry into why certain companies in this country are grossly overcharging Australians. Geographically, in terms of the social development of the countries we are comparing, we are looking for a reason. I just thought that you would have more justification. At least some of the others have offered us comparisons of certain products they have, like educational products, where they are offering quite inexpensive products in the Australian market. You have not offered us any cogent reason, other than your company policy, why you are charging more in Australia. I would like you to tell us why. What particular drivers force Microsoft to be charging up to 66 per cent more for their products in Australia than they would charge for the corresponding product in the US market?

Ms Marlow: I feel like you are looking for one simple, silver bullet, which I am telling you there isn't. We do see a range of things. If you are looking for some pricing comparisons similar to the one I gave before, I shared our Office Home Premium as \$199 including GST versus \$99 in the US excluding tax. That is our premium Cloud offering for Office for home. Our Office 365 Small Business Premium is \$13.50 a month here including GST and \$15 a month in the US. Those are our current prices for our premium offerings for small business and the consumer, which will demonstrate real agility as we embrace the Cloud, as I said in my first statement. For me it is around making sure we continue to build those products like our new Cloud products. We are bringing those to market. We are bringing them into a very competitive Cloud marketplace and we are hoping to win the hearts and minds of our customers with great products when they make those purchasing decisions in a very, as I said, competitive market.

Mr NEVILLE: What does Australia represent of the Microsoft international market? What percentage?

Ms Marlow: I do not know off the top of my head. I would have to do the maths, sorry.

Mr NEVILLE: From your headquarters in Australia do you, for example, look after New Zealand, Fiji, or Papua New Guinea?

Ms Marlow: We do not look after New Zealand. I believe we have some small Pacific Islands. I do not have the list of countries here for you.

CHAIR: You mentioned games before. We have mainly focused on music and software and the like, but games are, I think, bigger than movies now in terms of their entertainment dollar. Choice gave us a submission where they compared games that you might play on Xbox and other Microsoft products. There were games like Call of Duty where there is a 342 per cent differential between downloading it in Australia and downloading it in the United States. I know you perhaps cannot comment on other companies or game producers and whatnot, but would you concede that that is an issue for the Australian consumer if the differential is so high?

Ms Marlow: No, I would not. I believe we are not operating in a global economy where organisations need to have a global price. I believe companies should be able to lawfully set prices differently across the market that works for their business strategy, works with the different investments they make in those different markets, works based on the competitors they have in those markets and on the customer perceptions in those markets in a true supply-and-demand manner.

CHAIR: Presumably companies could charge what the market could bear? Would you agree with that?

Ms Marlow: Correct.

Mr STEPHEN JONES: In this inquiry we are attempting to dismiss all the plausible arguments that may be raised against cost differentials. The last question may have made this line of inquiry redundant. Are you familiar with *The Economist* magazine?

Ms Marlow: Yes, I am familiar with that.

Mr STEPHEN JONES: I am going to show you a chart, if I may. I will provide a copy to the secretariat as well. The table I am showing you is known as the Big Mac Index. I am not sure whether you are familiar with this. What it seeks to do is compare the price of a Big Mac in all of the countries that they have selected around the world, with the base country being the United States of America. You can see that Australia is at 4.94 per cent. Do you have that in front of you?

Ms Marlow: Yes, I do.

Mr STEPHEN JONES: It is on the lower end of the differential. Big Macs are produced using a complex array of utilities—labour costs would be a significant one. You would expect, if labour costs was a big driver of a differential, it would show up in this table, wouldn't you?

Ms Marlow: I am not an expert on this index and do not feel able to comment on its methodology or functions.

Mr STEPHEN JONES: What I am trying to do is establish that labour and associated costs could have no bearing on the differential between prices charged for IT products in Australia versus the United States, because there is a 9.4 per cent differential in the Big Mac index—that is, the price of a Big Mac in Australia versus in the United States—whereas there is an average of 30 to 70 per cent differential in the price of IT products provided by Microsoft in Australia versus the United States. Do you understand the point I am making?

Ms Marlow: I understand the point you are making.

Mr STEPHEN JONES: Would you say that it follows that, even though we are not flipping hamburgers, you would expect labour costs to be within a range closer to four or five per cent than 30 or 70 per cent if labour costs are the big driver of price differentials? You would, wouldn't you?

Ms Marlow: I am not going to comment on the methodology of that, but I would quote Treasury's submission, where it says:

Such differentials are not a new phenomenon, nor are they unique to Australia or the IT sector in particular.

I would also comment on the recent OECD statistics that came out, quoting that Australia was 66 per cent more expensive than the US on a basket of 3,000 goods that they looked at.

Mr STEPHEN JONES: But you would expect that if labour and utilities were the big drivers, that would show up in the Big Mac index. It has not. You have said that you are not an expert in this area, so maybe I will just move on. I want to go back to the issue that you have raised about essentially charging what the market can bear. You have said that this market in Australia that you operate in is not homogenous and it is quite competitive. Is that correct? Was that your evidence?

Ms Marlow: I said that globally we are not a homogenous market and that we do not operate with a single global price.

Mr STEPHEN JONES: I took your evidence to be that Australia it is quite a competitive market.

Ms Marlow: Yes, I said that Australia is a competitive market.

Mr STEPHEN JONES: It would be true though, wouldn't it, when it comes to the small business market that, if you are not using Microsoft, you are not in small business? You would have the lion's share of the small business market, wouldn't you?

Ms Marlow: I do not have the share details for small business. That is a question that has come to us before. What I would say is that we are competing very much in small business, frequently against open source software and free software. So we hope that if our customers see value in our product then they will make that choice. But, certainly, we have plenty of competition in that stake.

Mr STEPHEN JONES: You would be very surprised, I suspect, if you walked into any small business in the country and on one of their PCs they did not have Microsoft Excel and Microsoft Word—if you did not see a computer on a desk with a legal copy of Microsoft Word and Microsoft Excel, wouldn't you?

Ms Marlow: I am not prepared to represent the 1.2 million small businesses as to what is on their computers. I do know that many small businesses are choosing to use competitive products, including free products that are available in the market.

Mr STEPHEN JONES: Would you say that that was the overwhelming majority of small businesses in this country?

Ms Marlow: I do not have the share details for small business.

Mr STEPHEN JONES: Again, I put it to you that you are being evasive on this question. It is a pretty simple proposition: do you think the overwhelming majority of small businesses are not using your product?

Ms Marlow: I am standing by that I do not have the share details for small business. I do not know them.

Mr HUSIC: I think it might even be in the submission.

CHAIR: I think there is something—

Mr STEPHEN JONES: You can take that on notice.

CHAIR: Don't all go looking there at once.

Mr STEPHEN JONES: As to the proposition that I put to you, correct me if I am wrong, but I think these are your words: that you will charge as much as the market can bear. That might be the case in a very competitive market but I put it to you that, when it comes to the small business market, Microsoft operates and has the vast share of the small business market in this country. It is pretty simple: small businesses do not have the time, energy and expertise to go out there and download and access freeware or shop around for all the various IT products. They use similar or related products to the one they use at home, the one they learn at school, so they are more likely than not to be using Microsoft Word and Microsoft Excel. So effectively your 'charge what the market can bear' policy, which is leading to a 30 to 70 per cent product differential, is amounting to nothing more than a private tax on small businesses in this country. Would you agree with that?

Ms Marlow: No, I would not agree with that. I would agree that small businesses in this country have choice. There are a plethora of products they can use. There are other products that they can use today for similar functions, and they have a choice to make. We operate in the market very lawfully. We are out there competing every day on price and on the service of product.

Mr STEPHEN JONES: Nobody is suggesting that what you are doing is not lawful, Ms Marlow. You are running a very successful business, on which I congratulate you. Nobody could say that Microsoft does not have a fantastic business model. The proposition that I put to you is whether it is fair, from a regulatory point of view or from an ethical point of view, that small businesses in this country, which pretty much have to use your product, have to pay the price that you charge for them. It amounts to a private taxation on small businesses in this country.

Ms Marlow: Is the question do I agree with that?

Mr STEPHEN JONES: Yes.

Ms Marlow: The answer is that I do not agree with that, because I believe our small businesses have choice, that we are operating in a competitive marketplace and they have decisions to make. If we price our products too high, then our customers will make different choices. So we have to make sure that we spend \$10 billion a year to continue to develop those products, to be able to deliver great service, and we have to compete for that business every day.

Mr STEPHEN JONES: It is not true that they can simply change products, is it? If you are a small business in this country and you have got 10 years worth of sales information in Microsoft Excel software and backups and all the rest of it and your job is running a garage or a clothes store, not being an IT specialist, you are not going to rush out and buy a competitive product that does not automatically transload and upload all of those files. You have got a digital handcuff; you are locked into Microsoft's products and therefore you are locked into paying what Microsoft demands for those products because you cannot simply transfer your files from one program to another. That is true, isn't it?

Ms Marlow: I do not believe they are locked in, because they have a choice. Most of our software programs are built with interoperability in mind, so you can use tools to transfer data and technology. I hope if they have been using our product for 10 years they have seen value out it, that it has helped them run their business and that that is why they made the decision to make that acquisition in the first place. We have to keep building on those products, keep making sure we compete and innovate, keep making sure that we deliver the value they want, because they do have those choices in this market.

Mr STEPHEN JONES: Don't get me wrong: I am not saying that you do not provide quality products. I use them; I think they are quality products. The proposition I am putting to you is that this is not a fair market; this is a market where Microsoft can pretty much charge what it likes and the small businesses of this country must pay that price because they have little alternative.

Ms Marlow: Sorry, I am not sure of the question you are asking me.

CHAIR: I think you are editorialising, Mr Jones.

Mr STEPHEN JONES: Can I follow up a line of questioning Mr Husic put to you earlier. Does Microsoft have a policy of apportioning a return on the R&D it does to various country states?

Ms Marlow: Not to my knowledge.

Mr STEPHEN JONES: So it cannot be said that a proportion of that 30 to 70 per cent price difference between Australia and the United States is our fair share of re-investing in research and development?

Ms Marlow: No.

Mr HUSIC: You said you are not aware whether the R&D is apportioned to various markets. Are you able to provide information as to what portion of R&D is actually carried out here in Australia?

Ms Marlow: No, I am not.

Mr HUSIC: Why is that?

Ms Marlow: Because I do not know if we do that, if that is done.

Mr HUSIC: I think you invest, according to your submission, \$11 billion, is it?

Ms Marlow: \$10 billion a year.

Mr HUSIC: How is that R&D recovered?

Ms Marlow: The R&D is recovered through sales of our product globally.

Mr HUSIC: And those sales, as you admitted freely to this committee, are based on prices that are set at variance within different markets, correct?

Ms Marlow: As I understand your question, you are asking whether I can attribute a proportion of that R&D to Australia.

Mr HUSIC: No, sorry; I am more than happy to clarify. In the prices that you charge Australian consumers—you said earlier that Microsoft does charge differently for Australian consumers—how much of the R&D cost of \$10 billion is assigned to be recovered through the costs you extend to Australian consumers of your product?

Ms Marlow: I do not know that.

Mr HUSIC: Are you able to find out?

Ms Marlow: I could take that on notice.

Mr HUSIC: Excellent. I want to ask you this just to test something out. You may recall earlier that I asked you about market penetration and you indicated it was difficult to produce that figure because of the variety of ways in which you could slice that question, which I thought was a fair answer. The Microsoft Australia website states:

An estimated 17 million Australians—
we have 23 million Australians—

have used our software either at work or home—searching the Web with Internet Explorer and Bing, analysing data with Office Excel, sharing through Hotmail, playing on Xbox, communicating with Windows Phone or using one of our many business and server platform products.

Is it fair for me to assume that you have 17 million customers here in Australia?

Ms Marlow: I think you could take the statement as read that, at some point, 17 million Australians have searched on the internet, have used or touched our products in some form or function.

Mr HUSIC: I put this to Adobe earlier: you could understand my concern as an individual member of this committee that, given how widespread your reach is and in spite of the fact you operate as you say in a very highly competitive market—and, by the way, I do not disagree; it is clear that Microsoft does very well in that market—that if there are significant price differences that we have been able to demonstrate through some of the data we have provided to you, and I know you have countered with some examples, that Australian business and consumers are wearing that cost and that you are actually contributing to higher business costs in this country? Do you agree with that?

Ms Marlow: No, I do not agree with that.

Mr HUSIC: What element of my reasoning do you take—if I can use the word, and do not take this the wrong way—'exception' to, where you think that I may be reading this the wrong way? Given that I can quote to you, for example, Visual Studio 2010 Ultimate with MSDN membership is priced in the US at roughly \$12,000. In

Australia it is priced at nearly \$21,000. Windows 7 Ultimate is priced in the US at \$326; here it is priced at \$469. Office 2010 Professional, priced in the US at \$356 and in Australia at \$499. Microsoft Word 2010—that has a smaller price difference—\$142 in the US and \$189 here. Visio Professional costs \$570 in the US, \$900 here. But the staggering difference is Visual Studio, with a 72 per cent difference, \$12,000 in the States, \$20,000 here. Why should I not believe that your pricing approach here is not adding cost to business, that you then say is a justification as to why you charge in the way you do?

Ms Marlow: As I said from the start, we are clear that there are differences in prices due to geography. As I shared with you earlier, as we move to the cloud you will see us absolutely continue to incubate and innovate and take different pricing strategies. I mentioned prices before. Home and Premium costs \$119 here, including GST, and \$99 in the US without tax. 2000 Office 365 Small Business Premium costs \$13.50 a month here, \$15 a month in the US. Office Home and Business for small business costs \$299 here, including GST, and \$219 in the US. As we deal with different pricing strategies around the world, based on the different markets that we serve, that is going to occur and we will look at that.

If you let me talk to the Visual Studio example, and I believe you may be quoting from *Choice* magazine, as we looked at the Visual Studio example in the *Choice* submission they in fact looked at Visual Studio as a retail product. Visual Studio is a set of application tools for developers to build applications. It is typically sold to enterprises. In fact the retail version of that product has never been sold that I know of in Australia and, because we do want people to be developing on our software and on our platform, MSD provide those tools free to any consumer who wants to play with the development tools. They can access those free in this country. We work very hard to invest in that developer community.

I am sure you can find some details of numbers that will make a certain point but, at the end of the day, we are going to continue to look into the market we have, look at the competition we have and try to innovate our products because we hope that the 17 million Australians that are playing with our products, be it one of them or many of them, are getting value from them and are making the choice to purchase our products. We do want to sell our products, we do want to delight our customers and, if we set our prices too high, given our customers have choice, then we will see our sales fall. If we see our sales fall, that will impact on our business. So that economy, that supply and demand and those competitive forces will absolutely play out.

CHAIR: I do not want to interrupt Mr Husic's line of questioning. We heard some evidence previously that the cloud will act to reduce prices or even them out. Someone sent me a message that Xbox Live Gold in Australia is \$79.95 for 12 months and in the US it is \$59.99 for 12 months. It is a product that you go on the internet to get. Is that an example of the price being set to what the market will bear?

Ms Marlow: It is an example of there being a range of factors that we have put into the pricing model we have, including the price to support the products being delivered in the country. I am not an expert on the Xbox pricing. In Xbox Live Gold there are licensing arrangement that we may have to make in regard to content that you receive. It is different geographically. There may be different aspects to it. But it is an example regardless of being an on-premise, in the cloud, downloadable. There will be costs that we bear in country but there will be competition in country. There will be customer perception in country and there is competition in country.

Mr NEVILLE: Let me give you another example. You know the product Microsoft Office 2012 Home and Student Package. You are familiar with it?

Ms Marlow: I am familiar with that product.

Mr NEVILLE: It sells in the US for \$149.99—we will say \$150. It sells in Australia for \$209, \$60 more. That is about 40 per cent more. That is a download product and, unless you are buying the back-up CD as an extra, there is no boxing or packaging in that. It is all done as a download. How can a download product be 40 per cent dearer in Australia than in the US?

Ms Marlow: Office Home and Student 2013, which is the current version of the software, is \$169.00 ERP here including GST and \$139.00 in the US. So our price includes GST and the US price is without that, as I mentioned before. But ultimately we do not have a global price and the prices may be different in the US or other jurisdictions.

Mr NEVILLE: Feel free to correct me if that was wrong but we have taken advice from several sources in preparing our research.

Ms Marlow: I will give the Office 2013 Home and Student numbers. It is \$169.00 here including GST and \$139 in the US excluding tax. That is an example that we do not have a homogenous global pricing model. What you will see as we move into different countries in the world is that there will be different costs of operation in each of those countries. There will be different competitive landscape in those countries, different consumer

sentiment. As we said, if we set the price too high, the consumers will vote. We do not believe that there is anything unusual around having a multi-price strategy that is different in different geographies or segments.

Mr SYMON: I would like to not change the subject but to change to another part of it. That is upgrades. I will use myself as an example. I have been using Microsoft products since back in the days of DOS 3. Like many other people I have upgraded through that time. This probably touches on some of the things that Mr Jones raised. Once you are in the system, you keep going because it is a whole lot easier to stay, firstly, with what you know—and if it works that is good—but, secondly, because you have other programs installed that will not work on other systems. So all the way from those old days of DOS up to where we are now with much flashier Windows systems that are pretty good compared to what we used to have, there has always been that connection. Not only for someone like myself as a small user but for a small or even a large business it is a very big step to move away from that.

I want to take this to competition and choice because although you said there is competition and there is choice for the consumer, there is no choice for the consumer when it comes to Microsoft competing against itself. Sitting here in Australia, I cannot download a Microsoft product from the US at a cheaper price, not because of geo block in particular, but because of geo location. So when it comes to competition, is not Microsoft as a global company stopping that competition within its own borders between its divisions? Is that a fair way of putting what I see happening?

Ms Marlow: I think it is fair to say that we are using legitimate methods to manage our business and manage the differences in our business, and different locations around the world have a different environment.

Mr SYMON: If I were to purchase from a retail store in the US and upgrade to Windows 7, or if I were to purchase a full version and I could purchase it for a cheaper price there and get it shipped in the post here, would I be able to install that on my computer and have it run here?

Ms Marlow: I am not sure on Windows.

Mr SYMON: Are there any differences that you are aware of between Microsoft software in the US, for instance, and in Australia in terms of functionality or coding differences?

Ms Marlow: Not to my knowledge.

Mr SYMON: So we are basically talking the same product. There is nothing special done for the Australian version that could be picked up elsewhere in the world?

Ms Marlow: Not to my knowledge.

Mr SYMON: Again, I get back to this point: I can physically import a Microsoft program via the US and I can send it in the post and I can install it here. I can do that cheaper than I can if I download directly off the Microsoft site. Therefore, Microsoft is stopping competition with Microsoft.

Ms Marlow: Microsoft is using legitimate methods to help manage the different philosophies and business strategies that we will have in different parts of the world. As I mentioned earlier, we might be choosing to enter an emerging market and there is a very different pricing mechanism due to the economic standards of the particular countries and we want to be able to bring technology into those places. We look at how we drive investments based on consumer demand in certain countries and so we use legitimate methods to manage that and then to make sure that we are competing every day for our customers' business.

Mr SYMON: Moving on to another program, called the Home Use Program. I know of it. It is for volume licenses and to enable people to use their Microsoft products at home as well as at work. That is a good program that Microsoft runs. It allows people to use the product at home cheaply so they can do their work at home as well—which some people might say is not so good. But it offers a very cheap and accessible upgrade path and it does not seem to have a price differential and I am aware of between countries. If that can be done digitally at that level, then it would seem that the exact opposite is happening out in the retail world where the small business may only have one or two licences or where an individual buys a particular licence for an operating system, for instance. Is there a way forward? If you can show that it has been done now and has a fairly low and consistent price, is this where you are saying that the cloud model is going to change this so there are not the same sort of differentials?

Ms Marlow: I think the cloud model is still in its very early maturity stage. We believe there is great interest and excitement from our customers to leverage cloud technology. It might be a consumer who uses Outlook.com as a free messaging service, through to security and management software that is done from the cloud, to enterprise, messaging and collaboration in the cloud. There is certainly a great interest in infrastructure as a service, platform as a service and software as a service. So that interest is where it is going and, like all models we

have had in the history of the company, over time things change. Pricing strategies change and the competition changes. Many of the products that we are competing with in the cloud today belong to competitors far younger than Microsoft to an extent and so, because the market in IT is so dynamic and so innovative, it is very difficult to predict what will happen. But certainly we have observed over time adoption rates come through pricing changes and customer strategy. Whilst I do not know what the outcome would be, with my experience I would say that we would continue to see a great deal evolution and competition in a dynamic cloud market.

Mr SYMON: I would also like to ask you about OEM pricing. That is something we have not really touched on. It was seem to me to be an important part of the strategy that Microsoft have used in their marketing over the years, and that is, if the operating system is already stored on the brand-new computer, there is a great opportunity to have a new consumer on-board straightaway. There was a time years ago—I have not seen it recently—where retailers managed to get hold of large amounts of OEM software and would sell at retail versus the retail version. So there was an OEM price and a retail price. They were always far cheaper. Again, to me, if the product could be sold at one price, why is there a different price? Taking that to now—we have moved from the days when these things used to come on a large number of floppy disks, or maybe a CD or two, to where we are now—what is the difference? How important is that OEM market to a company like Microsoft?

Ms Marlow: Just to remind everybody, the OEM market stands for original equipment manufacturing market. Certainly, I would call the device market one of the most competitive landscapes we have. Looking around this room I see a number of Apple devices and Windows devices. We have to continue to evolve our Windows products and make sure it is delighting our customers. There is a tremendous amount of competition in that space that spurs us to keep innovating, delivering on Windows 8 and looking at what is next. It is an important part of our competitive landscape.

Mr SYMON: You said that there is no homogenous global pricing model. Does that extent across to OEM pricing as well?

Ms Marlow: I am not familiar with our OEM pricing. Most of our OEM relationships are managed by our corporate team. The relationship between Microsoft and Toshiba, for example, with regard to that, is managed corporately.

Mr HUSIC: I would like to go back to the issue of the channel. I have had an Australian Microsoft partner say to me that they are paying 50 per cent more. You charge on the basis of what the local environment is like. You take into account a range of things such as taxes and customs duties. Are these things factored into your pricing? What I do not understand is: if you do not have a direct distribution network, insofar as you rely on the channel to do it, then they are the ones who price on the way through. They deal with taxation. I assume that, for example, they are the ones who have to in the end levy the taxes, customs duties or whatever it is and take it into account, based on their own operations—labour, rent and other on-costs. It is not you, but you are still charging 50 per cent at the start, based on what that Australian Microsoft partner was saying. It goes through the channel and is priced to the end user. They are claiming that the product is 50 per cent more. How are you making those decisions on pricing? Is it purely on what the market will bear?

Ms Marlow: At the start, there are a range of costs that we bear in the local market. There are labour costs, rental costs and compliance with local laws. I talked to you about the state of the competition. That helps us set our pricing. The consumer perception of our product drives our pricing strategy. There is not a single thing that I could pull out and say, 'This is the single thing that drives that.' We absolutely continue to evolve what we do with our customers. We try to take the customer perception and the value that they get from our product into consideration as we do that, and we evolve that over time, because we are competing for their business every day. As I said to you, it is the most competitive marketplace that I have ever worked in in my time. That stands in a market where we do not have a single global market place in our perspective, and we will take in that local strategy and those local dynamics that are in place.

Mr NEVILLE: Do you have a recommended retail price list?

Ms Marlow: We have an estimated retail price list.

Mr NEVILLE: Does that exist in each country?

Ms Marlow: I believe so.

Mr NEVILLE: Could you let us have, for comparison purposes, your price list for Australia, New Zealand, the US, Canada, the UK and Singapore?

Ms Marlow: I would have to take that on notice.

Mr NEVILLE: Could you?

Ms Marlow: I would have to confirm and take that on notice.

Mr NEVILLE: If they are available, you will make them available—is that it?

Ms Marlow: Yes.

Mr NEVILLE: It is not that you have a policy objection to it?

Ms Marlow: For estimated retail price?

Mr NEVILLE: Recommended retail price.

Ms Marlow: Yes. You can see those on most websites of the subsidiaries.

CHAIR: It seems as though you have exhausted the committee, Ms Marlow. Thank you very much for your attendance here today. We certainly appreciate you coming and giving evidence before us. It has been most informative for the committee. The secretariat will be in touch with you about the additional information that you have agreed to give the committee. You will be sent a copy of the transcript of your evidence and you will be able to request corrections to errors of grammar and transcription. Thank you so much for coming.

Resolved (on motion by Mr Neville):

That this committee authorises publication, including publication on the parliamentary database, of the transcript of the evidence given before it at public hearing this day.

Committee adjourned at 14:10