gift & homewares australia

PART X Investigation

Asia-Australia Discussion Agreement

Australian Southbound Liner trades from North East Asia

Issues Paper

Submission in response prepared by
Gift and Homewares Australia

December 2003

INTRODUCTION

Gift and Homewares Australia (GHA) is the leading industry body representing the gift and homewares industry. GHA (the Association) has over 1400 members who are made up of importers, wholesalers, manufacturers and agents of gift and homewares.

GHA's membership is dominated by small business with around 94% of members having less than 20 employees. Members of the Association are a key part of the supply chain and, conservatively, we estimate that members supply in excess of 40,000 retail outlets nationally - including all of the major retail department stores and chains. It is reasonable therefore to conclude that increased costs imposed on our members have a significant potential to flow on to a large number of Australian consumers.

The Association's membership is reliant on inward bound container services as we estimate that approximately 80% of GHA members import product from overseas - with the vast bulk of this via sea. Members import an enormous variety of products, some of which includes:

- general gift items
- leather goods
- glassware
- jewellery
- kitchenware
- artificial Flowers
- manchester
- caneware
- tableware
- lighting
- craft/Handmade items
- children products
- toys
- body products
- ceramics/Pottery
- furnishings

In line with trends throughout the world, the majority of these imports are sourced from north east Asia, and the expectation is that this will grow significantly into the future.

The Association supports the broad principles that underpin the exemptions granted to Shipping Conferences under the Trade Practices Act 1974 (TPA). However, the privileges afforded to Shipping Conferences have the potential for abuse if not properly monitored and regulated. There is significant potential for a reduction in competition, especially where a Shipping Conference carries a large proportion of cargo from a particular region.

This submission examines the impact on GHA members of the rate restoration program that was implemented by parties to the Asia-Australia Discussion Agreement (AADA) during the second half of 2003, as well as the question of whether or not the AADA has led to any public benefit since its registration in April 2000.

BACKGROUND

In June 2003 the Association received a number of complaints from members about proposed increases in freight charges for shipping lines operating under the AADA.

The number of complaints grew steadily over following months and in September 2003 the Association's Board resolved to approach the Australian Competition and Consumer Commission (ACCC) to highlight our concerns.

In November 2003, the Association forwarded a Shipping Cost Survey to members that specifically covered shipping lines carrying inward bound cargo from north east Asia. This survey sought to:

- quantify the extent of price increases imposed on members;
- examine the level of competition that exists;
- examine service standards;
- determine the impact on member businesses of any increased freight charges.

8% of the Association's membership base returned their survey material, with the results of the survey being used throughout this paper.

THE CURRENT SITUATION

From information provided in our membership survey, AADA shipping lines dominate the north east Asian trade routes with 89.4% of members nominating that they use one or more of shipping lines who are party to this agreement. Table 1 below shows a percentage breakdown of AADA shipping lines used by members. Members were able to nominate more than one carrier.

TABLE 1 BREAKDOWN OF AADA LINES USED BY GHA MEMBERS

Shipping Line	% of Respondents Who Reported Using This Line
ANL	35.23%
COSCO	51.14%
Evergreen	14.77%
Hanjin	14.77%
Kawasaki	2.27%
Mitsui	9.09%
NYK	29.55%
P&O	28.41%
China Shipping	55.68%
FESCO	40.91%
Columbus Line	7.95%
Hyundai	10.23%
Maersk	28.41%
Mediterranean	23.86%
Orient	32.95%
Zim Israel	7.95%

Since June 2003, members of AADA have implemented significant increases in freight charges. According to the results of our Shipping Cost Survey, 99% of members who use an AADA line have faced cost increases.

According the ACCC Discussion Paper, shipping lines have increased charges by more than 100% since June 2003. This is consistent with the evidence of members, with Table 2 showing the average increase in freight charges reported by members, broken down according to each country of origin serviced by AADA shipping lines. Table 2 also shows the percentage of respondents who indicated that they imported products from ports in countries serviced by the AADA.

TABLE 2 AVERAGE COST INCREASES FACED BY GHA MEMBERS USING AADA LINES

Country of Origin	Av. Increase in Shipping Costs (Since June 03)	% Who Identified this as Country of Origin
China	77%	80%
Hong Kong	77%	56%
Japan	30%	1%
Korea	48%	1%
Philippines	49%	16%
Taiwan	68%	25%

Whilst the price increases for containers sent from countries such as Korea and Japan are lower than China or Hong Kong, it is significant to note that China and Hong Kong are by far the dominant countries of origin. 80% of members nominated that they ship product from China, while 56% nominated Hong Kong. In other words, the most significant increases have been focused on freight being sent from our two key trading partners in the region.

It is also important to highlight that the above increases are average results. From the evidence provided by members, some importers have faced increases of up to 300% and increases in excess of 100% were regularly reported in survey evidence. This indicates that some members may have been sheltered to some extent from increases under the rate restoration program because of pre-existing contracts or agreed rates and that it is likely that members were on a variety of different deals before the program commenced.

Care should be exercised in placing too much emphasis on interpreting the results from Korea and Japan as only a very limited number of members reported that they imported from ports in these countries. To that extent, the survey results for these ports of origin were skewed by data from some importers that was highly inconsistent with the general responses of participants.

Only 14 members reported using both AADA lines and non-AADA lines. The average overall price increase reported by these members was slightly lower, being 62% for containers shipped from Chinese ports and 67% for containers shipped from Hong Kong. Whilst these increases were lower than those in Table 2, the small number of members who pursued this avenue confirms that the ability to shop around for a better rate is very limited because of the dominance of the AADA lines.

It is expected that members of the AADA will implement further increases over the coming 6 months. One freight forwarding company has already advised customers that "*The carriers have just announced three further increases set for 2004, commencing from April with a view to increasing rates by a further USD 1000/20' and USD 2000/40'*."[1]

[1] Aust-Asia WorldWide Melb, email, 20 October 2003.

This view is reinforced by a recent article in the Age Newspaper where the consensus amongst both importers and shipping lines interviewed was that further increases would be implemented in 2004.[2]

The Association has held some discussions with the Importers Association of Australia (IAA) and it would appear that while the AADA is required under the TPA notify the IAA of changes to negotiable shipping arrangements, this process appears to have afforded little protection to shippers as it has neither been transparent or adequate. It is doubtful that the AADA can demonstrate that it has had due regard for the needs of importers.

IMPACT OF PRICE INCREASES

Have Importers Been Able to Negotiate Better Rates?

Survey evidence provided by members using AADA lines showed that the vast majority have not been able to negotiate better rates than have been notified by the shipping lines. 76% of members advised that they had been unable to secure better rates by using a different shipping line(s). Further, 80% indicated that they had been unable to negotiate a better price with their existing shipping line(s).

Where members have been able to negotiate a better rate, it would appear that the reduction has not been significant and that such concessions have only been available to those members who have been able to negotiate on the basis of volume.

Member responses also indicated that they have had to devote significant resources to finding alternatives, however, this has largely been to no avail as the figures above demonstrate.

Overall, there is little evidence to suggest that members of the AADA have moved away from the rates that have been published. Further, with 94% of GHA members falling within the category of small business, it is unlikely that volume discounts could be readily accessed by our members, leaving them extremely vulnerable to having to face the full impact of the AADA rate restoration program.

The survey also revealed that there is no real evidence to support a proposition that non-AADA lines have provided an alternative for importers. Only 11% of respondents reported using non-AADA lines and broadly speaking their experience with respect to both prices and service levels, was consistent with members using AADA lines.

Given the dominance of AADA lines, it is unlikely that non-AADA lines have the capacity to permit large numbers of importers to shift their business to them so there is very little incentive or ability for them to engage in serious competition.

[2] L Wood, 'Doubled Fees Chew Up Import Advantage', *The Age*, 4 December , 2003.

Have Importers Been Able to Pass on the Price Increases?

88.6% of respondents to the Association's survey indicated that they have been unable to pass on the price increases implemented by the AADA. There are a number of reasons why this is the case:

- increases have been implemented over a very short time period;
- competitive pressures in the domestic market;
- perception amongst retailers that prices should be coming down because of the rising value of the Australian currency;
- agreed pricing with forward orders;
- price lists are often issued by importers covering the following 6 to 12 months.

From comments provided on surveys, it would appear that the rapid appreciation of the Australian dollar in the second half of the year has partially offset the impact of rising freight costs. However, this can vary according to a range of factors including the value of the product being imported, and the extent of the price increases faced by individual importers. In this regard, a consistent theme of responses to our Shipping Costs Survey was that margins had suffered.

Outside of falling margins, the common themes amongst responses about the impact of rising freight costs on member business essentially fell into the following categories:

- the increases have eroded the benefit of the improved value of the Australian dollar;
- importers have largely been unable to pass on the increases;
- the increases have hurt cash flow with the up-front costs of landing a container having risen significantly;
- insufficient warning of increases did not allow importers time to adjust their pricing;
- retailers have been expecting price reductions following the rise on the value of the dollar;
- low value items have been hard hit by the rises.

There is little doubt that were it not for the rising Australian dollar, importers would have been in a much worse position. Over recent years, importers have absorbed much of the impact from the falls in the dollar and they could reasonably have expected to be able to restore some of their lost margins over the last 6 months. Unfortunately, any such gains have been offset by the cost increases imposed by parties to the AADA.

CAN MEMBERS SHIFT TO ALTERNATIVE SUPPLY SOURCES?

From the evidence supplied from members, it is clear that they are unable to quickly shift to alternative suppliers in other countries. In response to the following survey question, "*Are you able to easily source similar/same product from other countries in a short period of time*", 99% of respondents using AADA lines nominated that they were unable to do so.

The response from members using non-AADA shipping lines was in line with this result.

A number of factors would appear to preclude importers in our industry sector from easily moving to an alternative source of supply. These include:

- existing orders placed with suppliers;
- long gaps between major trade fairs in region (around 6 months);
- contractual obligations;
- importers are often tied into ranges, with seasonal designs that cannot be easily replaced;
- difficulty in sourcing reliable overseas suppliers;
- growing dominance of Chinese manufactured products;
- forward orders from retailers.

Clearly, the AADA have a captive market where importers of gifts and homewares are unable to easily source products from countries outside the north east Asian region.

QUALITY OF SERVICE

Current Levels

Despite the significant increases in rates since June 2003, there is strong evidence to suggest that service levels have actually declined during this period.

According to our survey, 50.5% of respondents were not satisfied with the current levels of service being delivered by the AADA member shipping lines. When asked to identify problems that had been encountered with the delivery of containers, up to three-quarters of respondents were able to identify problems and these are detailed in Table 3.

TABLE 3 COMMON PROBLEMS ENCOUNTERED BY IMPORTERS

Nature of Problem	% of Respondents Who Reported Their Business as Having Experienced the Problem
Late Arrival of Containers	53%
Containers Missed Connecting Vessel	39%
Difficulty in Securing Space	73%
Other problems	14%

The difficulty in securing space on ships is of particular concern as 92% of members who responded to the Association's survey indicated that they expected the volume of product imported from north east Asia to increase over the next two years. The expected rate of increase is illustrated in Table 4 below:

TABLE 4 EXPECTED INCREASE IN IMPORT VOLUMES FROM NORTH EAST ASIA BY END 2005

Expected Increase	% of Members Who Nominated Expected Increase
1 to 5%	0%
6 to 10%	21.25%
11 to 25%	36.25%
26 to 50%	27.5%
Greater than 50%	15%

Table 4 shows that during the next two years, 78.75% of members expect that the volume of gifts and homewares that they import from countries serviced by AADA lines will grow by 11% or more. Therefore, it is reasonable to conclude that unless additional capacity is introduced, particularly from ports in China and Hong Kong, prices will continue to rise and service levels will continue to fall.

Service Standards Since the Commencement of the AADA

Member responses indicate that the majority of members do not believe that there has been any real improvement in the quality of service from members of the AADA since it was first registered in April 2000. 15% of survey responses indicated that they felt service standards had improved over this period, whereas 54% believed that standards had not changed and a further 31% believed that standards had actually deteriorated.

Members using non-AADA lines appear to share these views, however, the ability to interpret the results with any certainty is limited due to the relatively low number of members using non-AADA lines.

On the basis of these results it is difficult to argue the proposition that the AADA has led to improved standards of service for importers operating in the gift and homewares sector. It is clear that an alarming number of importers are dissatisfied with current service levels and that generally the industry feels that service standards have remained static, or fallen.

GROUNDS FOR DEREGISTRATION

The Association submits that grounds exist for the Minister for Transport and Regional Services to give a direction under section 10.44 of the TPA to deregister the AADA. In this regard, subsection 10.45 (1) (a) (viii) (d) of the TPA allows the Minister to give such a direction where he is satisfied that "*there are exceptional circumstances that warrant the giving of a direction under section 10.44 (1)*."

Exceptional circumstances are outlined in the ACCC Discussion Paper as covering situations where an agreement:

- *(i)* *covers the substantial number of shipping lines and capacity in a trade; and*
- *(ii)* *where the conduct of those shipping lines has led to, or is likely to lead to, an unreasonable increase in freight rates: and/or*
- *(iii)* *unreasonable reduction in services;*
- *(iv)* *with the result being that the public benefit from the operation of the agreement is outweighed by the anti-competitive detriment.*

The evidence provided by respondents to our survey clearly shows that market conditions and the actions of shipping lines come within the exceptional circumstances criteria above.

Members of the AADA dominate the Southbound Liner Trade from north east Asia. From survey evidence, 89% of gift and homewares imports from this region come via AADA shipping lines. Recent experience also demonstrates that importers have largely been unable to shop around amongst any of the AADA and non-AADA lines for a better deal. This provides strong evidence to suggest that non-AADA lines do not have any real capacity to provide genuine competition to AADA lines.

When considered in conjunction with the fact that importers within our industry sector are unable to quickly switch to other countries to source product, it is clear that members of the AADA have the capacity to exercise enormous market power.

The evidence provided by members to the Association, as well as statements contained in the ACCC's own Issues Paper demonstrates that since June 2003, members of the AADA have exercised their market power aggressively and have driven up freight rates significantly. Freight rates have doubled in less than six months and indications suggest that there will be further increases in the new year. In a low inflation environment throughout the developed world, these increases can only be regarded as excessive.

The available survey evidence shows that there is a relatively high level of dissatisfaction amongst importers in our industry sector (over 50%) with the current service standards amongst AADA lines. Importantly, on the basis of survey responses, there appears on balance to have been no improvement in standards of service since the AADA was first registered in April 2000.

The available evidence also suggests that importers within our industry sector have largely been unable to pass on price increases.

The Association believes that when the ACCC considers:

- the extent of price increases, and their relatively short implementation period;
- the demonstrated inability of importers to pass on such increases;
- market conditions that provide for little competition amongst shipping lines;
- the relatively high level of dissatisfaction with service standards;
- strong evidence to suggest that service standards have not improved;

Then it is reasonable to conclude that not only have price increases been excessive, they clearly have been unreasonable.

The available evidence from our own membership suggests that the public benefits of the AADA appear limited - if any. Part of the reasoning for allowing Shipping Conferences to register under the TPA is to ensure adequate supply of container services. On the basis of evidence provided by members of GHA, it is arguable that the AADA is not satisfying this goal with strong dissatisfaction being evident and significant problems being encountered when trying to secure space on shipping lines.

On the other hand, there is clear evidence that members of the AADA have moved to increase prices aggressively, which has seen importers suffer an erosion of benefits from the rising Australian dollar and reduced profit margins.

In the longer term, wholesale prices will have to increase to reflect higher freight charges and, with members supplying a very significant number of retail outlets the ultimate cost will have to be borne by the consumer.

RECOMMENDATIONS

From GHA's perspective, a Shipping Conference should aim to deliver benefits to both the shipping lines as well as shippers. Unfortunately, the available evidence suggests that the AADA has exercised its market power at the expense of importers.

While the Association believes that there are grounds to deregister the AADA, we do not propose that this course be followed in the first instance. Instead, we propose that any provisions within the AADA that allow members to discuss and agree on pricing should be deregistered.

This would allow for more competitive pricing, while at the same time allow AADA members to discuss other areas of mutual benefit such as capacity sharing and expected future demand for services.

Furthermore, we submit that the ACCC should pursue undertakings from the AADA that require:

- consultation in a more open and transparent fashion with designated shipper bodies such as the Importers Association of Australia;
- member lines to provide greater notice of increases in order to allow adequate time for importers to adjust pricing;
- AADA members to address service standards in order to ensure that there is sufficient capacity and frequency to meet shipper's needs;
- AADA to agree to a review to be conducted by the ACCC within 18 months to determine whether or not undertakings made by members of the AADA have been met, and whether there is any evidence of collusion on pricing.

In the event that the AADA is unable to satisfy the ACCC that it has met the above conditions, or demonstrated satisfactory progress, then it would be open to the ACCC to recommend to the Minister for Transport and Regional Services that the AADA be deregistered. This would leave the Shipping Lines open to the full force of the provisions of the TPA.

The Association believes that the above measures represent a balanced approach to the issue. Whilst we are deeply concerned at the actions of the AADA, we are conscious of the need to ensure that importers are able to access sufficient and timely container services. The above proposal allows members of the AADA to address service issues, and at the same time addresses industry concerns about the lack of price competition that currently exists.