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COMMERCE COMMISSION

Decision No. 461

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

GE CAPITAL FINANCE AUSTRALASIA PTY LIMITED

and

AUSTRALIAN GUARANTEE CORPORATION (N.Z.) LIMITED

The Commission:	John Belgrave Donal Curtin
Summary of Application:	The acquisition by GE Capital Finance, or interconnected body corporate, of the business assets of Australian Guarantee Corporation.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	24 April 2002

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THE PROPOSAL

1. On 4 April 2002 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") from GE Capital Finance ("GE"), for it (or interconnected body corporate) to acquire the business assets of Australian Guarantee Corporation ("AGC").

2. GE seeks clearance from the Commission on the basis that the transaction will not have the effect of substantially lessening competition in any market in New Zealand.

THE PROCEDURES

3. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the Applicant. Accordingly, a decision on the application was required by 26 April 2002.

4. The Applicant sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

5. The Commission's determination is based on an investigation conducted by staff.

6. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

GE Capital Finance

7. GE ("the Applicant") is the financial services division of the US conglomerate, General Electric Co. based in Connecticut, USA. General Electric is listed on the New York Stock Exchange (its principal exchange), the Boston Stock Exchange and also on certain non-US stock exchanges, including the London Stock Exchange. General Electric globally operates a wide range of manufacturing and service divisions across a diversified spectrum of businesses including:

    - Global Exchange Services;
    - Industrial Systems;
    - Power Systems;
    - Lighting;
    - Medical Systems;
    - Mortgage Insurance;
    - Plastics;

[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

- Specialty Materials;
- Transportation Systems; and
- Capital and Finance.

8. General Electric is represented in New Zealand through a wide range of business subsidiaries and branches. However, the Applicant submits that the proposed acquisition only involves the financial division, which trades under the name "GE Finance and Insurance".

9. In New Zealand GE provides consumer finance (used by consumers to fund the purchase of "big ticket" items such as whiteware and furniture), motor vehicle finance, business finance (for equipment purchases and floor plans), and insurance products.

Australian Guarantee Corporation

10. AGC is a wholly owned subsidiary of Westpac Holdings NZ Limited. This company is in turn 100% owned by Westpac Banking Corporation of Australia. AGC is a 50% shareholder in AA Financial Services Ltd ("AAFS"), the other shareholder being the New Zealand Automobile Association Inc. Pursuant to joint venture and alliance agreements, AGC provides financial services to AA members. AAFS also provides life insurance products underwritten by Royal & SunAlliance. The AAFS shares and agreements form part of the assets to be acquired by GE.

11. AGC has a strategic alliance agreement with Hertz Fleet Lease Ltd. This contract is intended to be assigned to GE.

12. AGC is similarly involved in the provision of financial products in New Zealand including consumer finance (using a revolving credit facility accepted at participating retailers), motor vehicle finance (direct and via motor vehicle dealerships), and business finance (for example, asset purchases, leasing of vehicles, equipment, IT, fleet finance, and insurance premium funding).

OTHER RELEVANT PARTIES

Finance Companies

13. Relevant finance companies contacted throughout this investigation include:

Pacific Retail Finance

14. Pacific Retail Finance ("PRF") offers a range of investment and lending services directly to members of the public, retailers and their customers. PRF was incorporated in 1996 and is a wholly owned subsidiary of Pacific Retail Services Limited.

15. Together the two companies form the finance division of the Pacific Retail Group, which also includes Noel Leeming, Bond & Bond, Computer City, and Living & Giving. Pacific Retail Group is listed on the New Zealand stock exchange.

Dominion Finance Group Limited

16. Dominion Finance Group is a company specialising in short-term property development loans, often in association with prime bank funders, for the construction of residential apartments, commercial developments, and for a variety of other purposes. The company raises money from the public through the issues of registered secured debenture stock.

Fisher & Paykel Finance

17. Fisher & Paykel Finance ("F & P Finance") is a specialist finance company. The company is part of the Fisher & Paykel group of companies and is wholly owned by Fisher & Paykel Industries Limited. The company markets finance products through two main subsidiaries, Consumer Finance Limited and Equipment Finance Limited.

18. The company specialises in point of sale finance. It uses point of sale technology to help the retailer smooth the purchasing process. This allows consumers and businesses to acquire products using payment terms that match their budget and cash flow.

Finance Now

19. Finance Now provides hire purchase finance, personal loans and consumer insurances for customers throughout New Zealand. Finance Now is a subsidiary of the Southland Building Society.

Registered Banks

20. Relevant registered banks contacted throughout this investigation include:

ASB Bank Limited

21. The ASB Bank is a full-service, nationally operating bank and financial services company. It provides banking services that cover a range of financial options and has a customer base of 800,000 customers. ASB Bank is a wholly owned subsidiary of the Commonwealth Bank of Australia.

Bank of New Zealand Limited

22. Bank of New Zealand Limited ("BNZ") is the oldest banking institution in New Zealand. BNZ focuses on being a provider of financial services with products including loans, managed funds, retirement savings, insurance (life, general, health, travel) and private banking. BNZ is owned by the National Australia Bank Ltd.

INDUSTRY BACKGROUND

23. The provision of credit at a rate of interest is the core concept in the finance industry. This credit is offered in a multitude of forms and designed to appeal to a variety of market segments. Products include, credit cards, revolving mortgages, merchant cards, personal loans, and lines of credit to name a few.

24. Globally, the financial services industry is experiencing convergence—a lessening of the distinctions that have separated different types of financial products and services as well as the providers of these once-discrete products and services.

25. Driving the convergence trend are a number of powerful market forces: the changing demographic mix of retail financial services consumers; relaxed regulatory restrictions; market globalisation; and the increasing use of alternative distribution channels such as the Internet and toll-free telephone lines. Technological advances also facilitate the achievement of economies of scale.

26. The impetus behind financial industry convergence is the pressure to find growth through new markets and revenue streams. Financial service firms can not sustain profitability by offering only traditional banking services—the accumulation of transaction balances to lend at interest.

27. Banks, finance companies, building associations and several other types of organisations offer an increasingly wide range of financial services to consumers and business. To maintain a competitive presence in the financial service industry, financial institutions have sought to consolidate and rationalise their operations in an effort to generate greater efficiencies and cost reductions.

28. As an indicator of this industry trend in New Zealand, in 2000 Pyne Gould, the owner of Allied Finance, merged its other finance company holding, Finance & Discounts, into Allied Finance. Following this merger, Pyne Gould purchased MARAC Securities and Frontline Finance Limited. Frontline Finance was then absorbed into Allied Finance in 2001[2] creating the third largest finance company in New Zealand. Pyne Gould sought these acquisitions to create a finance group that catered to a number of segments in the industry and provided a more diversified earnings base.

29. The KPMG Banking Survey for 2000 notes that finance company profitability remained static in 2000 as a result of falling interest margins and increasing costs. In this competitive environment of shrinking margins, finance companies see an acquisition strategy as delivering reductions in operating costs while expanding their ability to offer a number of finance products to customers.

30. These product offerings can be grouped under four main headings:

    - Consumer finance.
    - Motor vehicle finance.
    - Business finance.
    - Insurance.

31. As indicated by the global convergence trend, a wide range of New Zealand financial institutions offer some or all of the financial services listed above. Finance companies compete with the five major banks in New Zealand, branch banks, building societies and savings institutions.

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[2] KPMG "Financial Institutions Performance Survey 2001"

MARKET DEFINITION

32. The Act defines a **market** as:

> *. . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.*

33. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

34. It is substitutability at competitive market prices that is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

35. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:
    - The goods or services supplied and purchased (the product dimension);
    - The level in the production or distribution chain (the functional level);
    - The geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
    - The temporal dimension of the market, if relevant (the timeframe).

36. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

37. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

Product Dimension

38. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products

that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

39. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[3] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the *'ssnip'* test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

40. The wider financial services sector has a range of segments under which lie an indeterminate number of market permutations. The market can be defined broadly or narrowly. There are a host of paths from which consumers and businesses can borrow money at any given time. This means the delineation between banks, credit card lenders and financiers is becoming less clear-cut.

41. The applicant notes it is debatable whether the provision of consumer finance and business finance constitute separate markets, or are segments of a wider lending and financial services market. However, GE states that however defined, the market participants remain the same, being the main finance companies, retail banks and credit card issuers.

42. GE suggests that the wider financial services sector is split into two dimensions: a consumer finance dimension, and a business finance dimension. This delineation seems well accepted in the finance industry. However, some segments of these markets appear to cross into other segments, which blur the product definition. For instance, a distinction between consumer and business finance fails to differentiate between motor vehicle finance products, which most market participants argue should be in a class of their own.

43. It can be argued that a number of finance products are substitutable on the demand side. Whilst there are variances between the different forms of lending with different terms, interest rates, payment conditions, and so on, consumers tend to utilise the different lending formats interchangeably.

44. When making a major purchase for instance, a consumer can choose to take advantage of the store's finance arrangements (through a finance company), pay for the purchase on a credit card, add the purchase to a pre-existing mortgage arrangement with a retail bank (if the consumer has a mortgage), or otherwise seek specific term finance from a bank in relation to the purchase. The options are not limited to one financial provider, nor to one type of financial provider. The range of financing available extends from finance companies, to credit card issuers to retail banks.

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[3] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

45. The same applies in respect of business finance options. A business customer can seek finance from finance companies who offer business finance solutions, from banks, and may in some instances use a business credit card for business matters (although usually for smaller ticket items).

46. The high level of substitutability between financing formats suggests that finance companies, banks and credit card issuers fall within the same market.

47. A distinction is however justified between consumer finance and business finance. Given a *ssnip* in the cost of business finance, a business finance customer is more likely to approach other business finance companies, or banks to source finance as opposed to finance companies that specialise in consumer finance for smaller ticket commodity items. UDC notes that its average business transaction ranges from [ ]. In comparison, consumer finance companies, such as F & P Finance, which focus on retail merchant sales, undertake financing transactions closer to [ ] on average.

48. It is arguable that consumer finance products and business finance products are substitutable on the supply side. Some companies, such as AGC, already provide both consumer and business financial products. However, whilst a business finance lender has the capacity to supply consumer finance products, the opposite is not necessarily true. Companies with a consumer finance focus are unlikely to have the appropriate credit analysis skills to be able to support a business transaction in the $50,000 to $7,000,000 range. In addition, a large number of finance companies tend to operate in a niche area, and most consumer finance companies who deal with merchant retailers do not offer business finance as well.

49. The above analysis supports the delineation between a consumer finance market and a business finance market.

Consumer Finance

50. The applicant defines consumer finance as the provision of finance to consumers (personal loans, store hire purchase, credit card type facilities) often used in connection with the purchase of goods (including motor vehicles). For the reasons set out below, the Commission has excluded motor vehicles from the consumer finance definition.

51. F & P Finance and other market participants confirm that the finance sector is very niche orientated with other specialist subset areas falling within the broad consumer finance market.

Business Finance

52. GE and AGC compete in the market for business finance. It is generally accepted that business finance is a separate and distinct market from consumer finance.

53. Business finance is defined by the applicant as the provision of finance to small and medium businesses for:

- The acquisition of capital items (e.g. plant), equipment and vehicles;
- Leasing activities; and

- Cashflow and floor plan requirements.

54. Industry participants agree that the market definition provided by the applicant is accurate.

Motor Vehicles

55. The Financial Services Federation delineates motor vehicles from the consumer finance category in estimating that the consumer industry alone is worth [ ] in New Zealand. AGC confirms that motor vehicles are a separate market. Application of a *ssnip* further suggests that a consumer wanting finance for a general commodity purchase is unlikely to request finance from a specialist motor vehicle finance company.

56. Similarly, on the supply side, motor vehicle finance is linked to motor vehicle dealerships. Without that link, a finance company is unlikely to finance car purchases. Note however that banks do service that particular market through specific motor vehicle loans, term loans, or through increased mortgage balance facilities.

57. The Commission notes that GE's presence in the motor vehicle finance market is negligible compared with other motor vehicle financiers. As such, the Commission has found it unnecessary to analyse the competition effects of the transaction in the motor vehicle finance market.

A Separate Merchant Market?

58. A number of market participants argue that the major concern of GE's acquisition in New Zealand lies in the retail finance market ("point of sale hire purchase market" or the "merchant market"). The Financial Services Federation notes that retail sales are the driver of consumer loans.

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60. PRF also raised concerns in respect of the merchant market as there are only five major competitors, soon to be reduced to four if the merger transaction proceeds. The direct competitors in this market include GE, AGC, PRF, F & P Finance, Retail Financial Services, Allied Finance and more recently, Finance Now. F & P Finance would also be concerned if the acquisition changed the ability of the merchants to operate effectively with consumers.

61. Some merchants are locked into a particular financier by virtue of the parent company. For example, PRF has exclusive financing rights for Noel Leeming, Bond & Bond, and Computer City, which are owned by the Pacific Retail Group, and Retail Financial Services has sole financing rights for Farmers and Deka outlets (the latter now dissolved).

62. AGC contends that most retail merchants have two or three financiers. AGC itself deals with [ ] merchants from large to small, out of a total of around 80,000 individual merchants nationwide. F & P Finance holds between [ ] merchant accounts. Most of these were established through historical relationships with merchants of Fisher & Paykel whiteware.

63. PRF argues that the portion of the merchant market not already tied into one or other of the competitors would become virtually inaccessible via the acquisition by GE of AGC. However, the relationship a particular financier has with its parent or sister companies does not deter other competitors from trying to capture that business. For instance, in September 2000 AGC approached Pacific Retail Group, the parent of PRF, with a "better" deal. Similarly, PRF itself attempted to secure business from Farmers, which is financed by Retail Financial Services.

64. The Commission considers that defining a retail merchant finance market is too narrow, particularly on the demand-side given the substitutability of credit cards and banking finance products (discussed below). However, on a conservative approach, and particularly with supply-side considerations, the Commission intends to view the retail merchant segment as a separate market. If the acquisition is accepted on this conservative approach, the acquisition will also be granted clearance under a broader market definition. The Commission has therefore considered the retail merchant market on its own merits in addition to the consumer finance market (not including motor vehicles).

Impact of Banks and Credit Card Issuers

65. The extent to which bank finance products (consumer and business) and credit card sales are to be included within the relevant product definition has also been examined. AGC confirms it is extremely difficult to source accurate figures for consumer finance in New Zealand given the crossover between finance companies, banks and credit card usage.

66. F & P Finance believes the broader consumer finance market is split into numerous segments including credit cards, durables (such as homes), motor vehicles, and merchants (selling smaller ticket home durables). Furthermore, F & P Finance suggest that credit cards are substitutable for other forms of consumer finance. The difference is that Visa, MasterCard, and other credit card issuers and banks are not able to take advantage of in-store retail package offers.

67. The crossover of product lines between finance companies and banks in the consumer market has increased, particularly with the development of a revolving mortgage product. This mortgage allows consumers to add new purchases (such as furniture, a car, boat or family holiday) onto their existing mortgage. Traditionally, these purchases would have been financed through a retailer scheme, motor vehicle trader and financier, or through a specific term loan or instalment loan from the bank. As a result, consumer retail financiers face indirect competition from mortgage lenders. However, the ability of a consumer to "ring-fence" its risk, or structure its finance for a particular purchase remains popular with consumers.

68. In addition, finance companies tend to lend more liberally, or at least to a different type of customer, compared to their banking competitors. Approximately [ ] of PRF's customers do not own their own home. PRF considers that it has more expertise at being able to manage its credit risk and delinquent loans in the consumer point of sale retail market than the banks.

69. PRF views banks and credit card providers as operating on the fringe of consumer financing. The banks have not penetrated the merchant retailers although they could attempt to enter this segment if they saw an opportunity to do so. Banks are further differentiated to the extent that they are unable to offer the same efficiency of service

currently offered by the larger finance companies. Historically, banks tend to stay away from high volume, low-ticket items.

70. Generally speaking, consumer financiers attempt to attain a 5-6% interest margin on loans where there is no other security except for the purchased commodity. Banks typically apply more stringent security terms but attain less in terms of margin (1-2%). The ASB confirms that the margins in the banking industry are narrow.

71. The Commission concludes that banks and credit card issuers are included in the consumer finance market to the extent that the products they offer are substitutable (even though interest rates on credit cards are higher). An application of a *ssnip* reveals that similar bank products and credit cards should be included in the market. This is largely consistent with the views of market participants, both in the consumer and business markets, who suggest that customers would switch to other financial product providers if the merged entity were to raise prices (i.e., increase the cost of borrowing above current market levels without justification). Switching can be effected almost immediately and without significant cost.

72. The Commission has again however, adopted a conservative approach in the first instance, and considered the consumer finance companies in their own right. The impact of the banks and credit card issuers is then considered as an additional constraint on the initial market assessment.

Undifferentiated/Differentiated Products

73. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.

74. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.

75. The Applicant notes that whilst money itself cannot be differentiated, the way it is lent can be differentiated. GE submits that the nature of the loan facility is influenced by a number of factors such as the amount of the loan, the perceived risk involved, the requirements of the lender and prevailing interest rates and market conditions. Further differentiating factors include:

- Type of facility;
- Term and repayment frequency;
- Security;
- Transaction costs associated with the use of the product; and
- Other terms and fees (application fee, repayment insurance).

76. F & P Finance, PRF and Dominion Finance Group confirm that service is the key differentiating factor before price. For instance, AGC operates seven days a week and

aims to answer a finance application within [ ], PRF aims to respond to an application as fast as [ ], F & P Finance within [ ] through its electronic approval system, and Finance Now within [ ]. However, they accept that price would at some point become the key differentiator. F & P Finance has to charge a premium compared with AGC as it has a higher administration cost, higher cost of funding (i.e. more expensive interest cost), and high service level facilitated through advanced technological systems.

77. PRF also notes that it cannot compete with AGC on price given that AGC acquires funds from interbank pricing at lower rates than PRF can fund itself. Therefore, PRF differentiates itself using the service aspect and charges a premium for that additional service.

78. The Commission is aware of the differentiation aspects noted above and has further addressed these characteristics at paragraphs 97 to 100. Nevertheless, the Commission maintains that the following identified product markets are appropriate (refer paragraph 101-):

- The market for consumer finance products (not including motor vehicles).
- The market for retail merchant finance (in the conservative alternative).
- The market for business finance.

Functional Level

79. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[4] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

80. The functional level is the supply of consumer finance products (or retail merchant finance) and business finance products.

Geographic Extent

81. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the

[4] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

overlapping geographic areas in which the parties operate are identified. These form initial markets to which a *ssnip* is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a *ssnip*.

82. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.

83. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

84. Most market participants spoken to advised the markets in which GE and AGC compete are national. This applies particularly to the larger finance companies operating through national chains. AGC confirms that the market is national – a customer of a major merchant in Invercargill or a customer of the same merchant in Whangarei can both have access to AGC's finance product.

85. At the lower end of the market there are a number of smaller finance companies operating at a more localised level. For instance, AGC informed the Commission that there are around 20 smaller finance companies operating in Nelson, and a similar number in Tauranga. Both these regions are identified as strong demographic growth areas.

86. The Commission concludes for the purposes of the current application that the geographical market is New Zealand.

Conclusion on Market Definition

87. The Commission concludes that the relevant markets are:

- The market in New Zealand for the supply of consumer finance products (not including motor vehicles).

- The market in New Zealand for retail merchant finance (in the alternative to the above)

- The market in New Zealand for the supply of business finance products.

COMPETITION ANALYSIS

Substantially Lessening Competition

88. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

89. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[5] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[6]

90. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[7]

91. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- The probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);

- The nature and extent of the contemplated lessening; and

- Whether the contemplated lessening is substantial.[8]

92. In considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

93. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

94. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be

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[5] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).
[6] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [ ] 1 All ER 289.
[7] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.
[8] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [ ] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [ ] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

95. In the absence of GE purchasing AGC, Westpac Holdings New Zealand Limited (which is owned by Westpac Banking Corporation in Australia) may sell AGC to another party although the Commission is not aware of any other interested parties. The Commission considers that the status quo is the most appropriate approximation for the counterfactual as AGC could continue to operate as a major financial services provider in the absence of the proposed merger proceeding.

96. The Commission therefore proposes to use the status quo as the counterfactual.

Potential Sources of Market Power

97. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

98. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one-year time frame.[9] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

99. In differentiated product markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

100. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.

[9] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

101. In the context of the consumer finance, retail merchant finance, and business finance markets as defined, where price, product quality and service are taken into account by purchasers in choosing between finance providers, the product is differentiated to a degree, and this has to be incorporated into the market analysis. However, the Commission considers that consumer, retail merchant and business finance products are not so differentiated as either to cast doubt on there being single, well-defined markets for those separate finance products, or to warrant the special analysis associated with fully differentiated products.

Conclusion – Competition Analysis Principles

102. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the status quo. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

103. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this Decision considers and evaluates the constraints that might apply in the defined markets under the following headings:

- Existing competition;
- Potential competition from entry; and
- Other competition factors.

ANALYSIS OF EXISTING COMPETITION

Introduction

104. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

105. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the

assessment of competition in a market. Those other factors are considered in later sections, as noted above.

106. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure that yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[10]

107. In determining market shares, the Commission will take into account the existing participants (including 'near entrants'). This is followed by a specification of the Commission's 'safe harbours', an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

The Market in New Zealand for the Supply of Consumer Finance Products (not including Motor Vehicles)

Existing Participants

108. GE contends that the consumer finance market is vigorously contested. The consumer finance market includes a wide range of competitors, from those specialising in property finance, to those offering a more general product range. Thus, there are a significant number of competitors offering consumer finance in addition to the Other Parties listed from paragraph 13 of this report. These include Allied Finance Ltd, Retail Financial Services Ltd, UDC Finance Ltd, FAI Finance, South Canterbury Finance, Nationwide Finance, and Dorchester Finance.

Safe Harbours

109. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

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[10] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

110. The Commission notes that market shares by themselves are insufficient to establish whether competition in a market has been lessened.

Market Shares

111. National shares for the consumer finance market are shown in Table 1 below. Total assets are used and generally accepted as a comparative measure.

Table 1:
Estimated National Market Shares for the Supply of Consumer Finance Products (excluding motor vehicles)

Company	**Total Assets involved in Consumer Finance ($millions)**	**Market Share (%)**
GE	[ ]	[ ]
AGC	[ ]	[ ]
Merged Entity	[ ]	[ ]
Retail Financial Services	[ ]	[ ]
F & P Finance	[ ]	[ ]
Pacific Retail Finance	[ ]	[ ]
Allied Finance	[ ]	[ ]
FAI Finance	[ ]	[ ]
Finance Now	[ ]	[ ]
Total	**[ ]**	**103.2**

112. The current three firm concentration, including only those companies listed above, is [ ]%. Post merger, the three firm concentration ratio would be [ ]% with the merged entity having a [ ]% share. These figures are outside Commission safe harbours.

113. However, as noted above, there are a number of other companies offering consumer financial services including UDC Finance Ltd, South Canterbury Finance Limited, Dorchester Finance Limited, and Nationwide Finance Limited. These companies and others were not included in Table 1 as the Commission was unable to verify the amount of total assets attributable to their consumer financial loans.

114. [

] Whilst UDC's reputation as a finance company is predominantly in the business finance area, it poses considerable constraint on the merged entity and other competitors in the consumer finance market by virtue of its substantial size.

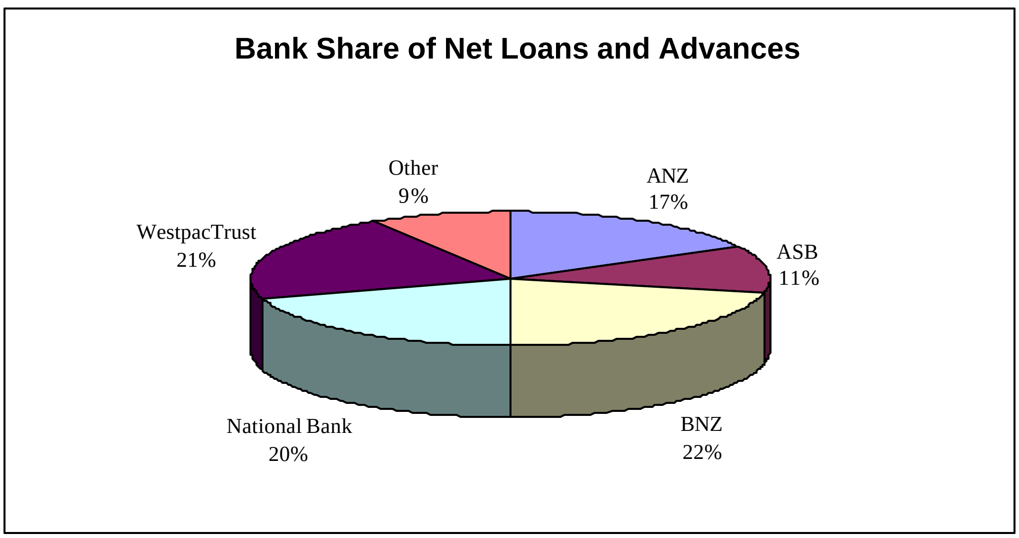
115. The value of the total consumer market in Table 1 is higher than estimated by the Financial Services Federation ("the FSF"). The FSF calculates that the entire consumer market (not including motor vehicles) is in the region of [ ]. Variances in calculations are inevitable given the difficulty in segregating certain parts of the market.

In addition, it is thought that many participants in the market (including the FSF) rely on information provided in the KPMG study. However, this study does not capture all facets of the market. For instance, Retail Financial Services Ltd, one of the largest competitors in the consumer finance market, opts not to provide information to the KPMG study.

116. In addition to the above market shares and other competition, banks and credit cards compete in the consumer finance market. To what extent is not exactly known, although as noted above, the banks and credit card issuers are making increasing inroads to the consumer finance sector via revolving mortgage products and increasing acceptance of credit cards as a form of payment nationwide, a trend that has become more important with the introduction of reward schemes.

117. Total non-housing loans to households in New Zealand total $7.1 billion as at February 2002.[11] This highlights that the consumer market is significantly larger than the [ ] estimated in Table 1. In addition, all credit card spending (including consumer and business spending) totalled $3.3 billion as at March 2002. The Commission estimates that at least $2 billion of the total would relate to consumer credit card debt. These figures highlight the considerable size of the consumer finance market as a whole.

118. In its application, GE provided a graph illustrating the portion of Net Loans and Advances attributable to banks in the financial and lending services sector. This graph is reproduced below.



119. The graph illustrates that the five main banks account for 91% of all Net Loans and Advances. The proportion of Loans and Net Advances offered by finance companies are then, by deduction, included under “Other” with 9%. Market participants generally agree that this graph accurately describes the presence of banks in the finance sector in comparison to the finance companies.

[11] Reserve Bank of New Zealand, Monetary Aggregates.

120. The following table provides, as an example, a breakdown of the ANZ Banking Group's Net Loans and Advances for the year ended 30 September 2001.[12]

Table 2:
Net Loans and Advances of ANZ Banking Group for the year ended 30 September 2001

Net Loans and Advances	$ millions
Credit card outstandings	495
Commercial bills	2
Hire purchase contracts	540
Term loans – housing	10,548
Term loans – non-housing	8,803
Overdrafts	1,702
Total	**22,090**

121. The ANZ notes that non-housing term loans include both personal and corporate customers. It would include term loans provided for cars, furniture and other big-ticket consumer items. Hire purchase contracts are accounted for separately and total $540 million. The home loan mortgage portion accounts for 48% of total net loans and advances.

122. The ASB advised the Commission that consumer loans make up less than 5% of its business.

123. For the year ended 31 December 2001, the BNZ has $28,854 million outstanding in loans. Loans secured by residential mortgages account for $10,574 million (or around 37%) of the total. The remainder would include a number of items including hire purchase contracts, overdrafts and term loans. Whilst only a proportion of the remaining total would fall into the consumer finance market, it illustrates that the quantum of bank net loans and advances that compete against the finance companies is not insignificant.

124. The Commission concludes that that the consumer finance market is significantly larger than indicated in Table 1. The market is not confined to those companies listed in Table 1 and includes other finance companies, registered banks and credit card issuers.

State of Existing Competition

125. Whilst [ ] initially intended to strongly oppose the acquisition, it conceded that it was more relaxed about the proposal in light of the relatively small size of GE's business in New Zealand. However, [ ] is concerned that the strength of GE and AGC combined in Australia will infiltrate to New Zealand via trans-Tasman retailing. GE's ability to transfer price to New Zealand is a concern also raised by [ ]. Current trans-Tasman retailers with Australian head office operations include Harvey Norman and Freedom Furniture.

[12] This time period differs to that used in the latest KPMG study which used figures from the 2000 income year. Figures obtained from the ANZ Banking Group's most recent Disclosure Statement.

126. In addition, [ ] are concerned that GE would undertake a strategy of discounting prices (reducing lending interest rates) in New Zealand post-merger. GE is believed to have unlimited recourse to capital backing and could therefore sustain itself through a below-cost strategy which would force other competitors out of the market.

127. [ ] does not think the merger will impact on the market although it conceded that GE could put pressure on its competitors by closing the margins. This would however depend on how much capital GE is willing to direct into the New Zealand company. GE suggests that it is more concerned with its Asian operations than with the relatively small Australian and New Zealand markets.

128. [

]

129. The Commission notes that the concerns about the merged entity relate to it becoming a more effective competitor, rather than to the prospect of it taking advantage of market power and raising prices.

130. The Commission also received indications of the market being very competitive. Five years ago, Dominion Finance Group was predominantly in the market of funding computers. However, they later decided to exit the traditional consumer market as they saw a limited future given the large number of retail financiers competing against each other, the increasing usage of credit cards for large ticket item purchases, and the decreasing price of computers in general.

131. Market participants suggest that margins face continuing downward pressure as the number of financing options available to consumers increases, and as products from banks, credit issuers and finance companies become increasingly similar.

132. The Commission concludes that existing competition from other finance companies, banks and credit card issuers in the consumer finance market is sufficiently robust to constrain the merged entity.

Conclusions – Unilateral Market Power

133. The Commission considers that the merged entity will be constrained by current competition in the consumer finance market.

The Market in New Zealand for the Supply of Retail Merchant Finance

Existing Participants

134. In the retail merchant finance market there are five major competitors, namely, AGC, GE, Retail Financial Services, Pacific Retail Finance and F & P Finance. In addition, Allied Finance and Finance Now operate in this market.

135. F & P Finance is generally thought to offer finance only in relation to whiteware. However, it notes that [ ]. F & P Finance operates through a number of merchants including [ ]. It cites AGC as its fiercest competitor. It does not come directly against PRF in a competition sense as PRF operates through its own group of merchants such as Noel Leeming, Bond & Bond, and Computer City. These stores traditionally do not stock whiteware product. However, they do compete for other merchants to some extent.

Market Shares

136. National shares for the retail merchant finance market are shown in Table 3 below. Total assets are used as the comparative measure.

Table 3:
Estimated National Market Shares for the Supply of Retail Merchant Finance

Company	**Total Assets Involved in Retail Merchant Finance ($millions)**	**Market Share (%)**
GE	[ ]	[ ]
AGC	[ ]	[ ]
Merged Entity	[ ]	[ ]
Retail Financial Services	[ ]	[ ]
F & P Finance	[ ]	[ ]
Pacific Retail Finance	[ ]	[ ]
Allied Finance	[ ]	[ ]
Finance Now	[ ]	[ ]
Total	**[ ]**	**100**

137. The current three firm concentration is [ ]%. Post merger, the three firm concentration ratio would be [ ]% with the merged entity having a [ ]% share. These figures fall in the order of Commission safe harbours [ ].

138. Again, the Commission notes the difficulty in determining accurate market shares. In addition to direct finance related to merchant sales, the Commission suggests that credit card sales, which are substitutable for finance company funding, and commodity purchase finance from banks (including those purchases added to a pre-existing mortgage facility) further dilute the concentration of the existing competitors in this market.

139. Table 2 illustrates that the ANZ Banking Group's hire purchase contracts (as an example) total $540 million alone, and are therefore substantially more significant than the total assets related to retail merchant finance offered by individual finance companies. Hire purchase contracts account for 2.4% of ANZ's total net loans and advances. Taking this into regard, the banks still pose a major constraint on competition for the smaller finance companies in the retail merchant market.

140. The Commission concludes that that the retail merchant finance market is significantly larger than indicated in Table 3. The market is not confined to those companies listed in Table 3 and includes registered banks and credit card issuers.

State of Existing Competition

141. Competition between the existing competitors is strong. In particular, [ ] is an aggressive company. Furthermore, Retail Financial Services Ltd, PRF and F & P Finance are all of a similar size in the marketplace, and are no smaller than the newly merged entity would be if granted clearance.

142. Whilst Finance Now concedes that it will continue to compete against GE in the personal loan market, it believes it will have no chance to compete against the newly merged entity in the retail merchant finance market. Finance Now is funded through local funds whereas GE sources its backing from Singapore and has access to cheap lending based on its AAA rating. GE is therefore able to offer 2% less on its interest charges than what Finance Now is able to offer. This again raises the argument that GE will be able to undercut cost margins and reduce competition in the market.

143. The Commission notes that the existing competition factors discussed in relation to the consumer finance market (see paragraphs 125 to 129) similarly apply to the retail merchant finance market.

144. [

]

Conclusions – Unilateral Market Power

145. The Commission considers that the merged entity will be constrained by current competition in the retail merchant finance market.

The Market in New Zealand for the Supply of Business Finance Products

Existing Participants

146. GE contends that the business finance market is even more vigorously contested than the consumer finance market. There are a significant number of competitors offering business finance in the New Zealand market.

147. UDC is generally considered to be the most vigorous competitor in the business finance market, although a broad array of other companies compete in this market also, including Allied Finance, Dominion Finance Group, Nationwide Finance, Pacific Retail Finance, and South Canterbury Finance.

148. The ASB views UDC as a competitor in the business finance market but other competitors (such as the other four major registered banks) are of more immediate concern to the extent that the ASB would not be pricing against UDC.

Market Shares

149. The Applicant provided figures for GE and AGC's receivables in the business finance market.

Table 4:
Estimated National Market Shares for the Supply of Business Finance Products

Company	**Business Finance Receivables ($millions)**
GE	[ ]
AGC	[ ]
Merged Entity	[ ]

150. The Commission was unable to establish the current three firm concentration given the limited information available. However, post merger, the merged entity will have close to [ ] in combined receivables. Market participants spoken to suggest, and the Commission accepts that the market shares of the merged entity would fall well within Commission safe harbours.

State of Existing Competition

151. UDC is a strong player in the business finance market having [ ] net receivables alone. Market participants intimate that they would be more concerned if GEC was applying to purchase UDC.

152. The FSF notes that any attempt to try and monopolise business lending in New Zealand is a fallacy – it is an extremely competitive market having tighter margins than in the consumer lending area.

153. Market participants suggest that margins face continuing downward pressure as the number of financing options available to businesses increases, and as products from banks, credit issuers and finance companies become increasingly similar.

Conclusions – Unilateral Market Power

154. The Commission considers that the merged entity will be constrained by current competition in the business finance market.

Scope for the Exercise of Coordinated Market Power

Introduction

155. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may

attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

156. In broad terms, successful coordination can be thought of as requiring two ingredients: ‘collusion’ and ‘discipline’. ‘Collusion’ involves the firms individually coming to a mutually profitable expectation or agreement over coordination; ‘discipline’ requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

157. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

158. “Collusion” involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

159. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 5. The significance of these is explained more fully in the Commission’s *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the financial services market. A high proportion of ‘yes’ responses would suggest that the market was particularly favourable to ‘collusion’; a high proportion of ‘no’ responses the reverse.

Table 5:
Testing the Potential for ‘Collusion’ in the Defined Markets

Factors conducive to collusion	Presence of factors in the market
High seller concentration	No.
Undifferentiated product	No – funds can be lent an innumerable number of ways.
New entry slow	No – entry can be effected within [ ]. For example, Finance Now.
Lack of fringe competitors	No – aside from banks and credit card issuers, building societies, and credit unions operate on the fringe of the financial lending market.
Price inelastic demand curve	Uncertain.
Industry’s poor competition record	No.

Factors conducive to collusion	Presence of factors in the market
Presence of excess capacity	Not relevant.
Presence of industry associations/fora	Yes – but very limited influence.

160. The Commission determines that the acquisition is not likely to affect the level of competitiveness in the industry for the finance products offered by GE and AGC. Whilst the levels of concentration in the consumer finance market and the retail merchant finance market surpass Commission thresholds, the markets are drawn very conservatively and do not include all finance company participants in those markets. Furthermore, GE and AGC have relatively small market shares in the consumer finance, merchant retail finance, and business finance markets taking similar bank and credit card products into account. In addition, there is a range of fringe competitors (including building societies and credit unions) that would be able to expand into the defined markets if the opportunity arose.

161. GE is not associated with any of the noted financial services companies. It operates as an independent, profit-motivated company.

162. Furthermore, prices are not especially transparent for the type of finance products offered by the specialist finance companies.

163. The Commission is therefore satisfied that the defined markets are unlikely to facilitate collusion. As such, the Commission has found it unnecessary in this case to go on to determine the potential for discipline in each of the defined markets.

Conclusions – Co-ordinated Market Power

164. The Commission has determined that the scope for the exercise of co-ordinated market power in the defined markets would not be enhanced by the acquisition.

Conclusions – Existing Competition

165. The Commission considers that existing competition in the defined markets will alleviate any concerns of unilateral power being exercised by the merged entity.

166. Furthermore, the Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced in any defined market by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Introduction

167. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

168. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

169. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

170. The constraints from market entry facing the consumer finance market and the business finance market are similar. Therefore, the following analysis applies to both markets.

Barriers to Entry

171. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

172. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.

173. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

174. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

175. Dominion Finance Group stated it is not difficult to enter the consumer finance market although it is difficult to make money. Consumers are easily attracted to competitive interest rates. Furthermore, there are no significant impediments preventing a current competitor from expanding its product range.

176. Finance Now notes that a serious contender for entry into the consumer finance market needs to have a good size financial backer. Funding a book is a challenge in New Zealand on a retail basis, whereas lending is easy. Finance Now was launched on [ ]. Beyond that, a new entrant would require commercial backing.

177. Finance Now informed the Commission that it has had some trouble breaking into the appliance and whiteware markets as there are a number of exclusive arrangements in place for financiers such as PRF, Retail Financial Services, and F & P Finance. These arrangements have the effect of slimming down the size of the market open to normal competition. However, Finance Now has merchant relationships with Dick Smith and Bedpost. These were acquired as a result of a friendly migration from Frontline Finance when it was purchased by the Pyne Gould Group. Finance Now has also created a niche for itself in regard to tyre and car accessories, and weaponry.

178. Finance Now also cites the larger compliance costs (expected with the revision of the Credit Contracts legislation) as a concern for new entrants.

The "LET" Test

179. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

180. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

181. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

182. GE concedes that entry is more likely to occur at the medium to small finance company level where the focus is on consumer and motor vehicle lending.

183. [ ].

184. [ ]. In addition, the ASB stated it would consider looking at the consumer finance market more closely if it could see opportunities in that area.

Extent of Entry

185. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

186. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that "toe-hold" position may be difficult because of the presence of mobility barriers, which may hinder firm's efforts to expand from one part of the

market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.

187. Whilst entry as a small-scale financier, in either the consumer or business finance markets is not difficult, it is more onerous to set up as national financier. However, as mentioned above, the national finance companies face the continued threat of competition from banks and credit card issuers.

Timeliness of Entry

188. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

189. The applicant suggests that a new entrant finance company would take 6-12 months to become established.

190. Finance Now is the most recent entrant in the consumer finance market. It notes that it put its initial strategic plan to Southland Building Society [ ]. In effect it took Finance Now [ ] to launch into the market. This included systems development and implementation, and ensuring legal compliance. The managing director and head of marketing are both ex-employees of Avco Financial Services, which was bought by GE in 1999, and have therefore brought a breadth of experience to Finance Now. Finance Now has managed to take some business from Retail Financial Services.

Conclusion on Barriers to Entry

191. The Commission concludes that there are no significant barriers to entry likely to deter expansion or new entry. Potential competition, in addition to the strength of existing competition in both defined markets, is likely to provide constraint on the merged entity, and the industry as a whole.

OTHER COMPETITION FACTORS

Constraint from Merchants (Buyers)

192. Merchants contacted by the Commission advised that it is easy to switch suppliers of finance. The switching costs of changing finance companies were negligible and considered no great barrier by merchants. With a number of finance providers in the market the merchants did not feel they were limited in their selection.

193. Merchants typically retain the services of at least two finance companies. Merchants feel it is important to offer consumers flexibility in the selection of finance.

194. The ease with which merchants can switch finance companies and the presence of several market players limits the ability of finance companies to impose uncompetitive rates on merchants.

OVERALL CONCLUSION

195. The Commission has considered the probable nature and extent of competition that would exist in the defined markets. The Commission considers that the appropriate benchmark for comparison is the status quo, in which the market is characterised by effective competition from existing participants.

196. The Commission has considered the nature and extent of the contemplated lessening of competition. The proposed acquisition would not result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines in the business finance market. Whilst the proposed acquisition would result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines in the consumer finance market, and the retail merchant finance market, the competitive constraint offered by additional finance companies, banks and credit card issuers substantially dilutes the conservative market shares recorded.

197. Existing competition in the defined markets is sufficiently robust to counter the effect of the merged entity's increased market share. Furthermore, low barriers to entry will impact on the merged entity's ability to exercise market power.

198. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in New Zealand in the defined markets.

DETERMINATION ON NOTICE OF CLEARANCE

199. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for GE Capital Finance (together with its subsidiaries and related companies), to purchase the whole of the business assets of Australian Guarantee Corporation (New Zealand) Limited.

Dated this 24th day of April 2002

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MJ Belgrave
Chair