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COMMERCE COMMISSION

Decision No. 500

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

PROCTER AND GAMBLE DISTRIBUTING NEW ZEALAND

and

WELLA NEW ZEALAND LIMITED

The Commission: MJ Belgrave
D Curtin
D Bates QC

Summary of Application: Procter and Gamble Distributing New Zealand has sought clearance to acquire all of the assets and stock of Wella New Zealand Limited as part of the global acquisition by the Procter and Gamble Company of Wella Aktiengesellshaft.

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: 10 June 2003

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EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to section 66(1) of the Commerce Act 1986 (the Act) was received on 12 May 2003. The notice sought clearance for an acquisition by Procter and Gamble Distributing New Zealand (PGDNZ) of all of the assets and stock of Wella New Zealand Limited (Wella NZ) as part of the global acquisition by the Procter and Gamble Company (P&G) of Wella Aktiengesellshaft (Wella AG).

Market Definition

2. The Commission concludes that, for the purpose of analysing this application, the relevant markets are as follows:
   - The national supply of hair care products (the hair care market);
   - The national supply of hair colourants (the hair colourant market); and
   - The national supply of hair styling products (the hair styling market)

   (the relevant markets).

Counterfactual

3. For the purposes of this investigation, the Commission believes that the appropriate counterfactual is the status quo.

Competition Analysis

Hair Care Market

<u>Existing Competitors</u>

4. The Commission considers that the hair care market is very competitive and would remain so after the proposed merger. It is of the view that market share is obtained through factors such as advertising, relaunching of products and innovation and that existing competitors of the merged entity are substantial companies that would be able to compete vigorously with the merged entity.
5. The Commission is also of the view that if the merged entity attempted to exercise market power by increasing prices by 4% to 5% it would lose sufficient market share to influence its pricing behaviour. The Commission is therefore of the view that the merged entity would be constrained by existing competitors in the hair care market.

<u>Potential Competitors</u>

6. The Commission concludes that barriers to entry in the hair care market are low and the likelihood, extent and timeliness of entry in the event of the merged entity attempting to exercise market power are sufficient to act as a constraint on the merged entity in the post acquisition market.

Hair Colourant Market

Existing Competitors

7. The Commission considers that the hair colourant market is very competitive and would remain so after the proposed merger. It is of the view that market share is obtained through factors such as advertising, relaunching of products and innovation and that existing competitors of the merged entity, particularly L'Oreal, are substantial companies that would be able to compete vigorously with the merged entity. The Commission is therefore of the view that the merged entity would be constrained by existing competitors in the hair colourant market.

Potential Competitors

8. The Commission concludes that barriers to entry in the hair care market are low and the likelihood, extent and timeliness of entry in the event of the merged entity attempting to exercise market power are sufficient to act as a constraint on the merged entity in the post acquisition market.

Hair Styling Market

Existing Competitors

9. The Commission considers that the hair styling market is very competitive and would remain so after the proposed merger. It is of the view that market share is obtained through factors such as advertising, relaunching of products and innovation and that existing competitors of the merged entity are substantial companies that would be able to compete vigorously with the merged entity.

10. The Commission is also of the view that if the merged entity attempted to exercise market power by increasing prices by 4% to 5% it would lose sufficient market share to influence its pricing behaviour. The Commission is therefore of the view that the merged entity would be constrained by existing competitors in the hair styling market.

Potential Competitors

11. The Commission concludes that barriers to entry in the hair styling market are low and the likelihood, extent and timeliness of entry in the event of the merged entity attempting to exercise market power are sufficient to act as a constraint on the merged entity in the post acquisition market.

Scope for the Exercise of Coordinated Market Power

12. The relevant markets are not susceptible to collusion, post acquisition. In particular, the markets are very dynamic with constant new products, differentiated products, and frequently changing market shares. The Commission therefore considers that the proposed acquisition is unlikely to enhance the scope for co-ordinated market power in the relevant markets.

Modelling

13. The modelling work carried out suggests that, while prices may rise up to 4% for some products, the weighted average price rise in any of the markets will be no more than 2.5%. It should be noted that the model is based on an assumption of no entry. It therefore shows that existing competition is such that even without entry, prices may only increase by a small percentage after the merger, thus verifying the Commission's analysis. The Commission, however, is of the view that entry barriers are low and entry likely with the result that price increases, if any, would be even less than those predicted by the model.

Overall Conclusion

14. The Commission has concluded that the merged entity would be constrained from exercising market power in the relevant markets by existing and potential competitors. The Commission has also concluded that the proposed acquisition is unlikely to enhance the scope for coordinated market power in the relevant markets. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the relevant markets

THE PROPOSAL

1. On 16 May 2003 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 (the Act) from Procter and Gamble Distributing New Zealand (PGDNZ). The notice sought clearance for PDGNZ to acquire the assets and stock of Wella New Zealand Limited (Wella NZ) as part of the global acquisition by the Procter and Gamble Company (P&G) of the business of Wella Aktiengesellschaft (Wella AG).

THE PROCEDURES

2. 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 11 June 2003.
3. In its application, PGDNZ 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.
4. The Commission's determination is based on an investigation conducted by staff.
5. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

PGDNZ

6. P&G is a large multinational manufacturer and distributor of consumer goods and is listed on the New York Stock Exchange. Internationally, P&G's portfolio consists of around 300 product brands in 50 product categories supplied to almost 160 countries. P&G has an annual turnover in excess of US$40 billion and invests approximately US$1.6 billion each year in research and development. It produces a number of products in the hair colour, styling and care market including Pantene and Herbal Essences.
7. P&G produces products in five main categories: baby, feminine and family care; fabric and home care; beauty care; heath care; and food and beverage. The company now owns and operates the Clairol business (Nice & Easy, Herbal Essences), bought from Bristol-Myers Squibb in 2001.
8. P&G spends in excess of US$5 billion on advertising, two thirds of which is done outside of the United States.
9. PGDNZ does not manufacture products and is merely the importer (primarily from Australia) and distributor for P&G products within New Zealand. PGDNZ sells hair care products, hair colourants and hair styling products to supermarkets, pharmacies and variety stores such as Kmart and The Warehouse. PGDNZ currently does not sell products through hair salons. The brands sold by PGNZ are set out in Appendix 1.

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[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.

10. P&G is also involved in the fine fragrance industry and manufactures the Hugo Boss, Herve Leger, Helmut Lang, Old Spice and Giorgio Beverley Hills ranges which are distributed in New Zealand by CS Co.

Wella NZ

11. The Wella AG Group is primarily focused on the hair cosmetics market for consumers, the hair cosmetics market for hairdressers and the market for fine fragrances. It is represented in 123 countries and employs nearly 16,000 people worldwide.

12. Wella NZ is a subsidiary of Wella AG and imports (from Australia and Germany) and distributes its hair products into the New Zealand market. Wella NZ distributes a range of products in the hair styling, care and colour markets to local retailers and has a professional range which is distributed only to salons. The brands sold by Wella NZ are set out in Appendix 1.

13. Wella NZ intends to import [ ]

14. Wella AG distributes fine fragrances in New Zealand through BDM Grange. The Gucci, Anna Sui, Yardley, Dunhill, Sabatini, and 4711 fragrances are amongst its portfolio.

OTHER PARTIES

L'Oreal

15. The L'Oreal Group worldwide sells over 200 products under 500 brands and is active in all areas of cosmetics including hair care, hair colour and hair styling aids. L'Oreal currently operates a professional, luxury and consumer products division within New Zealand.

16. L'Oreal currently sells hair care products to pharmacies under its L'Oreal Paris brand and to hair salons under its L'Oreal Professional and Kerastase brands, but does not currently sell hair care products to supermarkets. [ ]

17. L'Oreal sells colourants and hair styling products to supermarkets, pharmacies and variety stores. Its brands are set out in Appendix 1.

Unilever

18. Unilever plc is engaged in the distribution of branded and packaged consumer goods, including food, detergents and personal care products. The company also has interests in specialty chemicals. Unilever manufactures many personal hair care products in Australia under its Dove, Sunsilk, Frutrience, Timotei and Rexona Essentials brands which are distributed nationally within New Zealand.

Schwarzkopf

19. Schwarzkopf & Henkel is the cosmetics division of the Henkel Group which is based in Germany. The Henkel Group has subsidiaries in more than 75 countries and has a total of around 45,750 employees.

20. The Schwarzkopf & Henkel division sells hair care, hair colourant, hair styling, toiletries, skin care, and oral hygiene products and fragrances in 150 countries. It had sales of 2085 million Euro in 2001.

BDM Grange

21. BDM Grange sells cosmetics, toiletries, perfumes and hair car products. It sells hair products to the retail market but not to salons. Its main hair product brands are Andrew Collinge, VO5, Alberto Salon Formula and Tresemae.

Beiersdorf AG (Beiersdorf)

22. Beiersdorf is a large international company based in Germany. It owns several international brands such as Juvena, Elastoplast and Nivea. Nivea skin care products have been sold in New Zealand for many years. [ ]

PSM Healthcare (PSM)

23. PSM manufactures shampoos and conditioners in New Zealand and supplies them under its own brand, Health Basics, and to supermarkets as house brands.

CTFA

24. The Cosmetics, Toiletries and Fragrances Association (CTFA) was founded in the early 1970's. Its stated aim is dedication to the achievement of the highest standards of excellence in the manufacture and marketing of products that enable people to enhance their appearance, mood and self esteem. The Association acts as a centre for international trade enquiries and is involved both nationally and internationally in the development of industry specific standards.

Supermarkets

25. Supermarkets sell approximately 51.5% of all hair products sold in New Zealand and 77.5% of hair products sold through the retail market (does not include salons).

26. Progressive Enterprises Ltd (Progressive) is owned by Foodland Associated Limited (FAL), a public company incorporated in Western Australia. FAL conducts wholesale and retail supermarket operations in Western Australia and New Zealand. Progressive holds approximately 45% of the New Zealand grocery market and operates the Foodtown, Woolworths, Countdown, Big Fresh and Price Chopper supermarket banner groups.

27. The other supermarket chain is Foodstuffs which has a market share of 55%. There are three separate Foodstuffs companies: Auckland, Wellington and South Island. Each Foodstuffs company is a cooperative, owned by the individual owners of supermarkets within the chain. They share ownership of Foodstuffs (New Zealand) Limited, which is a small company used primarily as a lobby group, and which represents the three cooperatives on industry bodies. Foodstuffs (New Zealand) also owns the banners New World, Pak'N Save, and Four Square and leases those to the three Foodstuffs companies.

28. The supermarkets sell house brand shampoos and conditioners as well as branded products. The house brands make up approximately 2% of all shampoos and conditioners sold in the retail market.

Variety Stores

29. Variety stores such as Kmart, The Warehouse, Rendells and Farmers sell approximately 7.8% of all hair products in New Zealand and approximately 11.7% of hair products sold through the retail market (does not include salons). Prices in these stores are similar to those in supermarkets.

Pharmacies

30. Pharmacies sell approximately 7.2% of all hair products sold in New Zealand and approximately 10.8% of hair products sold in the retail market. Pharmacy prices are typically substantially higher than those in supermarkets and variety stores.

31. The three main pharmacy brands are Amcal and Unichem, which are owned by Pharmacy Brands Group Ltd, and Guardian. There are also a substantial number of pharmacies that do not operate under one of the above brands.

INDUSTRY BACKGROUND

Structure

32. The total hair products market in New Zealand is worth approximately $209.3 million dollars of which 51.5% is sold through supermarkets, 33.5% through hair salons, 7.2% through pharmacies and 7.8% through variety stores such as Kmart and The Warehouse.

33. The industry is made up of a number of participants each holding a less than ten percent market share with the exception of Wella NZ, Unilever and PGDNZ which hold 17.2%, 13.8% and 17.6% respectively.

34. Hair products are sold in supermarkets, pharmacies, variety stores and hair salons, although there is often some difference in the products available at each outlet. Currently, the products sold to salons are not available to the consumer through general retail outlets. Salon products differ from retail products in volume, formulation, specification and price which, to some extent, reflects the value of the service being purchased concurrently with the product. However, industry participants said that the line between the salon and retail outlets is

narrowing with more salon type formulations appearing on the general market and a general growth in demand for high quality products at premium prices. Wella NZ has a presence in salons through its professional range whereas PDGNZ does not supply to salons.

35. All suppliers within the industry, with the exception of PGDNZ, which has a distribution centre, supply directly to retail purchasers. Virtually all of the products sold within each of the product segments are imported with most being manufactured either in Australia or Europe. Contracts, particularly in relation to the large grocery sellers, are rare due to the wish of supermarkets to be free from constraint in managing their product portfolios.

36. Pharmacies are more inclined to focus on pharmacy only brands in order to try and differentiate themselves from supermarkets.

Hair care segment

37. PGNZ is the largest participant in the hair care segment of the market. It consistently retains a 25% share through its 'Pantene Pro V' product alone, which combined with the rest of its portfolio, gives it a market share of around [ ]. Wella NZ holds around [ ] of this market with Unilever ([ ]) and BDM Grange ([ ]) being the other two strong industry participants.

Hair colourant segment

38. The hair colourant segment consists of four industry participants of roughly equal size namely: PGDNZ, Wella NZ, L'Oreal and Schwarzkopf. L'Oreal is fairly new to the market but has quickly grown its market share to be comparable with the other participants within the industry. It has a large presence in pharmacies and has attempted to segment its products to provide a point of difference.

39. The hair colourant segment is viewed as a growth market with its value increasing 8.3% in the last 12 months to around $30 million.

40. Hair colourants are purchased as a self-application pack through a retail outlet for personal use and are usually sold as a service in salons.

Hair styling segment

41. Hair styling products are products designed to enable hair to be shaped or moulded in some fashion including hair spray, gel and mousse.

42. The styling segment consists of seven to eight participants and has been described by industry participants as competitive. Wella NZ holds the largest share of the market with around [ ], followed by Unilever and BDM Grange who hold [ ] and [ ] respectively.

Conduct

Hair care segment

43. Supermarkets have a degree of power in deciding which products to stock. Such decisions are based on the particular company's ranking, the popularity of the product, continuity of supply, their existing range, the presence of a good sales force, the suitability of the product in relation to the supermarket's mark up policy and the supporting 'above the line' expenditure budget. The product is then usually trialled with decisions to discontinue the product or reallocate shelf space based on sales during that period. All retailers spoken to seemed open to taking on new products subject to the existence of the factors listed above.

44. Advertising is seen as extremely important within the industry with a common perception that sales are dependant on it to a large extent. The hair care segment does not exhibit a high degree of brand loyalty. Demand is highly elastic with large spikes and troughs in demand normally observable around price promotions, particularly amongst the cheaper products in grocery outlets.

45. Industry participants said that the ease of entry into the market would depend on the availability of a good formulation. Establishing a reputation within the industry, in order to compete with the incumbent firms, would also be difficult. It was also suggested that it may be easier for a company with an existing presence in a related cosmetic area to expand into producing products for the hair cosmetic market. Unilever's brand Dove has recently entered the segment successfully on the back of its success in the skincare market. The Commission has also learned that [ ] intends to launch a product into the hair care market [ ] later this year.

Hair colourant segment

46. Industry participants advised that brand loyalty may be more of a feature in the hair colourant segment due to the perceived risk in deviating from a known and proven product and due to its semi permanent nature.

47. Fashion is particularly important with hair colourant products with product launches and relaunches being frequent occurrences in order to cater to the latest fads and trends.

Hair styling segment

48. Technology and marketing are seen, by industry participants, to be particularly important to the success of a product in this segment of the hair cosmetics industry. Fashion also plays a big role.

49. Industry participants said that pricing is particularly important as the effectiveness of each of the various brands of each type of product does not vary to any great extent.

MARKET DEFINITION

50. 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.*

51. 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.

52. The Commission defines 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).

53. The Commission aims to define the 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.

Relevant Markets

Product Dimension

54. 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.

55. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[2] 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.

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[2] 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".

Demand-side substitution

56. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

57. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must already be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable for the hypothetical monopolistic supplier.

Supply-side substitution

58. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

Undifferentiated/Differentiated Products

59. 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.

60. 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.

Product definition analysis

61. The Applicant submitted that the relevant product markets are those for shampoo/ conditioners, hair colourants, and hair styling/hair sprays.

62. All industry participants spoken to agreed that there were three separate types of product which were not substitutable from a demand side and which involved different manufacturing processes – hair care (shampoos and conditioners), hair colourants, and hair styling products.

63. The Commission is of the view that these product markets are appropriate for the purposes of competition analysis.

<u>Hair Salon and General Retail Products</u>

Hair Care Products

64. Hair products are supplied either to hair salons or to general retail outlets such as supermarkets, pharmacies and variety stores. Each supplier supplies different products to salons to those supplied to retail outlets. Industry participants said that salon products generally differ in technical specification to those available in retail stores. Many products are designed to target specific problems which can be identified by hairdressers. Most considered salon products constituted a separate product market distinct from products available in general retail outlets.

65. However, the technical gap between salon formulated products and general retail products is closing with a number of salon type products starting to appear in the supermarkets. The Andrew Collinge range supplied by BDM Grange is an example of a product that is sold only in salons overseas but is available in New Zealand supermarkets.

66. Differentiation between salon products, pharmacy products and general retail products is reflected in the price. Higher priced products in the supermarket and variety stores are available for around $10 whereas the cheaper priced salon products start at around $15. To some extent these higher prices reflect the added value of sales advice and personal assistance offered at a salon but not at a supermarket or variety store.

67. Although differences in formulation do exist, the Commission believes that there is a degree of supply side substitutability between the production of salon and retail products. The production of the products requires fundamentally the same production methods and machinery without a substantial investment in sunk costs required to switch between producing the two.

68. Furthermore, the higher prices in pharmacies, which are considered by suppliers as being part of the general retail outlets rather than being grouped with salons, are very similar prices to the lower prices in salons.

69. After considering the above, the Commission considers that although products are differentiated to some extent, the differentiation is not sufficient to prevent the different brands from being substitutable for each other. Accordingly, the various brands and products are not so differentiated as to affect the market definition.

Hair Styling Products

70. Styling products available from the salon and the supermarket also differ in price but to a much smaller extent then that which is exhibited in the hair care market.

71. The products sold in the supermarkets and the salons are very similar both in terms of application and in what they are designed to do. Switching between salon products and supermarket products is a regular occurrence.

72. The Commission believes that there is a high degree of supply side substitutability between the salon and supermarket styling products with formulation and packaging being fundamentally similar. No significant additional investment in sunk costs would need to be made to facilitate the transition from manufacturing for the salon to manufacturing for the supermarket.

Hair Colourants

73. Hair colour can either be purchased in a self-application pack for personal use from the supermarket or a colour service can be purchased in the salon where the colour is applied by the hairdresser.

74. The supermarket and salon alternatives differ substantially on price with the cost of a colour pack in the supermarket costing around $10 to $14 per application whereas a colour treatment in the hair salon may cost five or six times that amount. Again, to an extent, the difference in price represents the cost of the service, advice and in some cases luxury of the colouring process.

75. Industry participants generally drew a distinction between salon colour products and retail colour products. This distinction was drawn primarily on the view that low cross price elasticity of demand is exhibited between the two alternatives.

76. The Commission believes that there is limited technical supply side substitution between the retail and salon hair colourant alternatives due to their inherent differences in terms of formulation, application and in packaging.

77. There is less substitutability between general retail colour products and those supplied to salons and it could therefore be argued that there are separate markets for colourants supplied to salons and colourants supplied to general retail outlets. However, the competition effects on both types of colourants of the proposed acquisition are very similar.

Conclusion on Salon and General Retail Products

78. The Commission therefore is of the view that it is not appropriate to consider separate markets for salon hair care, colourant, and hair styling products and general retail products.

Conclusion on Product Dimension

79. The Commission concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product markets are the markets for:

- hair care products;
- hair styling products; and
- hair colourants.

Functional Market

80. 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.[3] 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.

81. The vast majority of hair products are manufactured overseas and imported by local subsidiaries which represent the domestic operations of the international hair care product companies. The Commission has learned of only two industry participants, namely PSM and Palmolive who manufacture in limited quantities domestically. Both PGDNZ and Wella NZ are the local distributors for the products manufactured by P&G and Wella AG respectively.

82. The Commission believes that the relevant functional level for the purposes of the investigation is the supply of hair products.

Geographic Market

83. The Commission seeks 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 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.

84. 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.

85. PGDNZ, Wella NZ and all other industry participants supply and distribute their products all over the country. All parties interviewed believed that the market was a national one.

86. The Commission believes the relevant geographic markets for hair care products, hair styling products and hair colourants to be national.

Conclusion on the Relevant Markets

87. The Commission concludes that, for the purpose of analysing this application, the relevant markets are:

- The national supply of hair care products (the hair care market);
- The national supply of hair colourants (the hair colourant market); and
- The national supply of hair styling products (the hair styling market).

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[3] *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.”

The Fine Fragrance Market

88. PGNZ is not involved in the supply of fine fragrances in New Zealand as P&G distributes them through CS Co. Wella NZ is also not involved in the New Zealand fine fragrance market as Wella AG distributes them through BDM Grange.

89. Accordingly, the acquisition covered by the application for clearance does not involve the fine fragrance market. Furthermore, information obtained from industry participants indicates that the combined presence of P&G and Wella AG in the fine fragrance market in New Zealand would be well within the Commission’s safe harbour guidelines and would be unlikely to raise any competition issues.

90. The Commission therefore did not consider this market any further.

COMPETITION ANALYSIS

91. For each relevant market, the Commission assesses:

- 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 any contemplated lessening resulting from the acquisition (the factual); and
- whether the contemplated lessening is substantial.[4]

92. The Commission uses 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 (the factual), 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 evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

Factual

93. In the factual scenario, the merged entity will be the single largest participant in the hair products market with approximately [ ] of the hair care segment, [ ] of the hair colourant segment and [ ] of the hair styling segment.

94. Some rationalisation of the product portfolio is foreseen by many industry participants post acquisition although it is thought that the key brands belonging to each company will continue.

[4] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* (1987) 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* (1990) 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

Counterfactual

95. The applicant has made no submission on the relevant counterfactual in its application.

96. The acquisition of Wella AG is a result of a successful bid of [ ] by P&G. [

]

97. However, there is no indication that Wella NZ is a failing company and there is every indication that in the absence of the acquisition, Wella NZ would continue to operate within the hair products market as it has done so for many years.

98. It is possible that Wella AG may be acquired by another company if the sale to P&G did not eventuate but there is not sufficient information to indicate by which company.

99. Therefore, for the purposes of this investigation, the Commission believes that the appropriate counterfactual is the status quo.

The Hair Care Market

Constraint from Existing Competitors

<u>Market Concentration</u>

100. 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.

101. 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 which 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.[5]

102. In determining market shares, the Commission will take into account the existing participants (including 'near entrants'), inter-firm relationships, and the level of imports. This is followed by an application of the Commission's 'safe harbours'

103. 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

[5] See the Commission's Practice Note 4 for further explanation of the Commission's approach to market share.

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%.

104. The total hair care market sold through retail outlets excluding salons is approximately $84.63 million. Market share information has been provided by the applicant and other industry participants. Estimated shares are shown in Table 1. Information about sales to salons is very limited and has not been included.

Table 1: Market Shares in Hair Care Market

Supplier	**Market Share (%)**
P&G	[ ]
Wella NZ	[ ]
Unilever	[ ]
BDM Grange	[ ]
Colgate Palmolive	[ ]
Schwarzkopf	[ ]
Johnson & Johnson	[ ]
Revlon	[ ]
Others	[ ]
Total	**100.0**

105. Table 1 indicates the merged entity would have a market share of [ ] and the three firm concentration would be [ ]. This is outside the Commission's safe harbour guidelines.

106. Market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include the constraint provided by existing or potential competitors as well as other competition factors such as the countervailing power of buyers and suppliers. These are considered for the relevant market in subsequent sections.

Analysis of Existing Competitors in the Hair Care Market

107. The applicant made no submission in its application about constraint provided by existing competitors. However, P&G when interviewed pointed out that there is a high level of competition in each of the hair product markets. P&G stated that marketing is important and that to remain competitive, products need to be relaunched annually or biannually. It said that there are five to eight relaunches of hair care products each year.

108. P&G advised that its Pantene brand remains the number one seller because:

- P&G constantly assesses the needs of customers and reformulate and repackage the products accordingly;
- P&G tres to assess where trends are going into the future and reformulate ahead of time; and
- The brand delivers what the customers want.

109. P&G advised that the company had lost its focus on its Pert product and that it had steadily declined in market share as a result.

110. It said that consumers have three or four brands in their “consideration scope”. For example, if they buy Pantene, they probably also buy Sunsilk or Dove (Unilever) as well. If one product goes up in price, the customers will stop buying that product and will buy the other two and add another to their “consideration scope”. It claimed that customers have low brand loyalty.

111. Other industry participants stated that the three hair care markets are dynamic and very competitive. BDM advised that the key determinants of success are:

- Advertising;
- Good formulation; and
- Fragrance.

112. The importance of substantial spending on advertising in order to maintain market share was confirmed by all participants spoken to. Progressive and Foodstuffs, for example, advised that all the suppliers with larger shares have large advertising budgets and that those not performing are those with limited advertising spend and lack of innovation.

113. The Commission was advised that even strong brands owned by significant suppliers such as the merged entity would have to be supported by substantial spending on advertising to retain market share. L’Oreal said that if PGNZ’s advertising spend on Pantene reduced, it would lose market share. [ ] It said that the best way to make a product successful is to enter the market with a big spend behind it and be prepared to keep spending on advertising.

114. All participants also emphasised the importance of frequent relaunches of a product to maintain its market share. A relaunch can involve some or all of reformulation, repackaging, new fragrance, or new pack size. Wella NZ advised, for example, that Wella Balsam was relaunched every two to three years. Industry participants also advised that existing suppliers frequently launched new products or ranges.

115. Industry participants were of the view that hair care products are price sensitive and that there was little brand loyalty. They stated that if the merged entity attempted to exercise market power by increasing prices by 4% to 5%, it would lose market share. Schwarzkopf said that a 5% price increase would be “corporate suicide” and that it would result in loss of market share. CTFA advised that [
.]

116. Unilever was the only industry participant to state that the merged entity may be able to increase the price of Pantene by 5% and not lose market share. It stated, however, that the lower end products were too price sensitive to be able to increase prices to that extent. BDM Grange was of the view that if you normally sold a shampoo for $5 and sold it for $4 you would gain market share but that if you increased it to $6 you would lose market share. It

stated that the merged entity could only increase prices if it was able to convince consumers through advertising that there was a reason for the price increase.

117. The Commission is of the view that the merged entity would not be able to increase the price of any of its products by 5% without also changing the product and backing it with extensive advertising.

118. Industry participants informed the Commission that there was vigorous competition for supermarket space and that this could only be obtained by providing support for the product with substantial advertising as described above.

Conclusion on Existing Competitors in the Hair Care Market

119. The Commission considers that the hair care market is very competitive and would remain so after the proposed merger. It is of the view that market share is obtained through factors such as advertising, relaunching of products and innovation and that existing competitors of the merged entity are substantial companies that would be able to compete vigorously with the merged entity.

120. The Commission is also of the view that if the merged entity attempted to exercise market power by increasing prices by 4% to 5% it would lose sufficient market share to influence its pricing behaviour. The Commission is therefore of the view that the merged entity would be constrained by existing competitors in the hair care market.

Constraint from Potential Competitors in the Hair Care Market

121. 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.

122. 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.

123. 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.

124. 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.

Barriers to Entry

125. The Applicant submitted in the application that there are no barriers to entry. PGDNZ when interviewed said that the barriers to entry are low and that new products are generally tried by consumers if they have a good advertising campaign behind them.

126. Supermarkets advised that they choose new suppliers based on:

- Above the line spending (advertising carried out by the supplier) of at least $300,000 a year;
- Continuity of supply;
- Competitive pricing;
- A good sales force; and
- A good distribution network.

127. Pharmacies choose suppliers based on:

- What consumers are buying;
- The reputation of the supplier; and
- Whether a supplier is more focused on pharmacies than supermarkets in order to give a point of difference.

128. Variety stores use similar criteria.

129. De novo entry into the hair care market on a small scale appears to be relatively easy with the only potential difficulties being in sourcing a good formulation and establishing a distribution network.

130. However, expansion from that initial small scale entry may be difficult. The establishment of a good reputation in the industry is a potentially lengthy and costly task for a new entrant. Such a reputation is important in terms of increasing consumer demand and also in establishing a trading relationship with the various retail outlets. Such a reputation would require a large and continued investment in both advertising and promotions.

131. The need for such advertising was emphasised by all industry participants spoken to. Unilever, for example, said that barriers to entry are low but that it is expensive to maintain position due to the large investment in advertising required. Schwarzkopf was also of the opinion that there are no real barriers to entry but that it is essential to continue advertising. It said that it is necessary to advertise on TV and in print in the first two years at least.

132. Other industry participants said that if continuity of supply and a certain level of advertising support could be guaranteed for a product then supermarkets would be willing to allocate shelf space to it at least on a trial basis. However, the required advertising spend represents a barrier to entry in itself.

133. It appears that entry into the hair care market for a firm with an existing presence and reputation in a similar cosmetic market may be significantly easier and more practical. Unilever’s brand, Dove, recently made a successful transition from skincare into the hair care market and has rapidly grown its market share to around [ ] in a relatively short space of time, primarily trading off the back of its strong reputation in skin cosmetics. Such entry would allow a fair degree of cross subsidisation and economies of scale in terms of research and development, production costs and potentially advertising expenditure. Furthermore, these companies are well able to afford the required cost of advertising to support new brands.

The “LET” Test

134. 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

135. The hair care market is characterised by numerous instances of product reformulation, repackaging and relaunching. Industry participants said that consumers are willing to trial a new or relaunched product, particularly if they can offer a point of differentiation. The launch of a new product under an existing brand or the relaunch of an existing product can be viewed as tantamount to new entry. Such an entry could be achieved relatively inexpensively as there would be no need to invest in new technology with the required production and manufacturing facilities already in place.

136. The Commission has learned of two suppliers [ ] that intend to enter the hair care market later this year [ ]The recent introduction of Dove and Palmolive hair care products are examples of the ability to successfully enter the market this way. Pharmacies have recently selected two new suppliers – [ ], both of which are salon brands in the UK.

137. The Commission has also learned of various international suppliers that could potentially supply the New Zealand market including Johnson & Johnson, Sedel and Trydel Rose though it is thought that the New Zealand market is already highly competitive and well serviced.

138. Although supermarket house brands currently constitute only about [ ] of the hair care market, the recent emergence of house brands, particularly in the area of hair care, would also suggest that entry into the market is both possible and likely. It has been suggested to the Commission that house brand shampoos and conditioners are likely to become more common place in supermarkets within the next year.

139. Industry participants have also said that PSM Healthcare, which manufactures the Health Basics brand and some house brands, is capable of entering the market in its own right.

140. As discussed above with respect to existing competitors, industry participants advised the Commission that consumers will switch to other products, particularly if the price of their current brand increases, and are willing to try out new brands.

Extent of Entry

141. Despite some concerns regarding the extent to which a de novo entrant could penetrate the market, the Commission believes that entry by a corporation with an existing infrastructure in a similar cosmetic market, such as [ ], may be able to achieve a significant market share within a relatively short period of time as evidenced by the success of Dove and Palmolive.

142. The Commission considers that entry into the market would be sufficient in extent to constrain the merged entity should it attempt to exercise market power.

Timeliness of Entry

143. The Commission believes, in terms of an existing overseas manufacturer supplying the New Zealand market, new entry could be achieved reasonably quickly. Logistical arrangements would be required to be made with the various retail outlets though these

arrangements are not so onerous as to suggest that entry could not be achieved within a few months.

144. Further, the Commission understands that [ ] intend to launch products into the hair care market within the next twelve months.

145. The Commission is of the opinion that entry could be achieved within a time period sufficient to act as a constraint on the exercise of market power.

Conclusion on Constraint from Potential Competition in the Hair Care Market

146. The Commission concludes that barriers to entry in the hair care market are low and the likelihood, extent and timeliness of entry in the event of the merged entity attempting to exercise market power are sufficient to act as a constraint on the merged entity in the post acquisition market.

Scope for the Exercise of Coordinated Market Power in Hair Care Market

Introduction

147. 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.

68. "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.

148. The structural and behavioural factors that are usually considered conducive to collusion are set out in the left-hand column in Table 2. 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 reusable crate hire 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 2: Testing the Potential for 'Collusion' in the Hair Care Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes.
Undifferentiated product	No – very differentiated products.
New entry slow	No
Lack of fringe competitors	No.
Price inelastic demand curve	No.
Industry's poor competition record	No.
Presence of excess capacity	No.
Presence of industry associations/fora	No.

149. Table 2 suggests that the hair care market is not susceptible to collusion, post acquisition. In particular, the market is very dynamic with constant new products, very differentiated products, and frequently changing market shares. The Commission therefore considers that the proposed acquisition is unlikely to enhance the scope for co-ordinated market power in the hair care market.

The Hair Colourant Market

Constraint from Existing Competitors in the Hair Colourant Market

150. The total hair colourant market sold through retail outlets excluding salons is approximately $32 million. Market share information has been provided by the applicant and other industry participants based. Estimated shares are shown in Table 3. Information about sales to salons is very limited and has not been included.

Table 3: Market Shares in Hair Colourant Market

Supplier	**Market Share (%)**
P&G	[ ]
Wella NZ	[ ]
L'Oreal	[ ]
Schwarzkopf	[ ]
Revlon	[ ]
Unilever	[ ]
Others	[ ]
Total	**100.0**

151. Table 3 indicates the merged entity would have a market share of [ ] and the three firm concentration would be [ ]. This is outside the Commission's safe harbour guidelines.

Analysis of Existing Competitors in Hair Colourant Market

152. The comments above in paragraphs 107 to 114 describing the key determinants to success in the hair care market and the importance of advertising and frequent relaunching of products also apply to the hair colourant market. The hair colourant market is even more dynamic as it is more subject to fashion and trends. New products or ranges are introduced more often in the hair colourant market than the hair care market.

153. Industry participants advised that there is more brand loyalty in the hair colourant market than in the hair care market. Schwarzkopf said that although brand loyalty was stronger, after a product had been in the market for about a year, it was necessary to compete on price.

154. The vigorous competition for supermarket space that can only be obtained by providing support for the product with substantial advertising also exists for hair colourants.

Conclusion on Existing Competitors in Hair Colourant Market

155. The Commission considers that the hair colourant market is very competitive and would remain so after the proposed merger. It is of the view that market share is obtained through factors such as advertising, relaunching of products and innovation and that existing competitors of the merged entity, particularly L'Oreal, are substantial companies which would be able to compete vigorously with the merged entity. The Commission is therefore of the view that the merged entity would be constrained by existing competitors in the hair colourant market.

Constraint from Potential Competitors in Hair Colourant Market

156. The hair colourant market faces similar barriers to entry to those to the hair care market and accordingly paragraphs 125 to 133 are applicable to the hair colourant market.

157. However, the hair colourant market faces a further condition of entry in that new products require approval from the Environment Risk Management Authority (ERMA) under the Hazardous Substances and New Organisms Act 1996. However, this would not appear to be a significant barrier to entry because it would cost only about $5000.

158. The comments regarding likelihood, extent and timeliness of entry concerning the hair care market in paragraphs 135 to 145 are also applicable to the hair colourant market subject to the additional consideration of ERMA approval required to enter the market.

159. Although any potential new entrant would require their products to be registered under the Hazardous Substances and New Organisms Act 1996 the Commission believes that the registration process does not warrant a finding that entry is unlikely or not timely.

160. The Commission believes that entry is likely and sufficient in extent and timely enough in the hair colourant product market to act as a sufficient constraint on the use of market power by the merged entity.

<u>Conclusion on Constraint from Potential Competitors</u>

161. The Commission concludes that barriers to entry in the hair care market are low and the likelihood, extent and timeliness of entry in the event of the merged entity attempting to exercise market power are sufficient to act as a constraint on the merged entity in the post acquisition market.

Scope for the Exercise of Coordinated Market Power in Hair Colourant Market

162. The hair colourant market, like the hair care market is not susceptible to collusion, post acquisition. In particular, the market is very dynamic with constant new products, very differentiated products, and frequently changing market shares. The Commission therefore considers that the proposed acquisition is unlikely to enhance the scope for co-ordinated market power in the hair colourant market.

The Hair Styling Market

Constraint from Existing Competitors in Hair Styling Market

163. The total hair styling market sold through retail outlets excluding salons is approximately $24.8 million. Market share information has been provided by the applicant and other industry participants. Estimated shares are shown in Table 4. Information about sales to salons is very limited and has not been included.

Table 4: Market Shares in Hair Styling Market

Supplier	**Market Share (%)**
P&G	[ ]
Wella NZ	[ ]
Unilever	[ ]
BDM Grange	[ ]
Schwarzkopf	[ ]
Helena	[ ]
Others	[ ]
Total	**100.0**

164. Table 4 indicates the merged entity would have a market share of [ ] and the three firm concentration would be [ ]. This is outside the Commission's safe harbour guidelines.

<u>Analysis of Existing Competitors in Hair Styling Market</u>

165. The comments above in paragraphs 107 to 114 describing the key determinants to success in the hair care market and the importance of advertising and frequent relaunching of products also apply to the hair styling market. The hair styling market, like the hair colourant market, is, however, even more dynamic as it is more subject to fashion and trends. New products or ranges are introduced more often than in the hair care market.

166. The comments from industry participants regarding the price sensitivity of hair care products in paragraphs 115 and 117 also apply to hair styling products.

167. The vigorous competition for supermarket space that can only be obtained by providing support for the product with substantial advertising also exists for hair styling products.

<u>Conclusion on Existing Competitors in Hair Styling Market</u>

168. The Commission considers that the hair styling market is very competitive and would remain so after the proposed merger. It is of the view that market share is obtained through factors such as advertising, relaunching of products and innovation and that existing competitors of the merged entity are substantial companies which would be able to compete vigorously with the merged entity.

169. The Commission is also of the view that if the merged entity attempted to exercise market power by increasing prices by 4% to 5% it would lose market share. The Commission is therefore of the view that the merged entity would be constrained by existing competitors in the hair styling market.

Constraint from Potential Competitors in Hair Styling Market

170. The barriers to entry into the hair styling market are the same as those in the hair care market as described in paragraphs 125 to 133 above.

171. Due to the similarity in market conditions and barriers to entry with regard to the hair care and hair styling markets the comments concerning the likelihood, extent and timeliness of entry in paragraphs 135 to 145 are equally applicable to both markets.

172. The Commission believes that entry is likely and would be sufficient in extent and timely in the hair styling product market to act as a sufficient constraint on the use of market power by the merged entity.

<u>Conclusion on Constraint from Potential Competitors</u>

173. The Commission concludes that barriers to entry in the hair styling market are low and the likelihood, extent and timeliness of entry in the event of the merged entity attempting to exercise market power are sufficient to act as a constraint on the merged entity in the post acquisition market.

Scope for the Exercise of Coordinated Market Power

174. The hair styling market, like the hair care and hair colourant markets is not susceptible to collusion, post acquisition. In particular, the market is very dynamic with constant new

products, very differentiated products, and frequently changing market shares. The Commission therefore considers that the proposed acquisition is unlikely to enhance the scope for co-ordinated market power in the hair styling market.

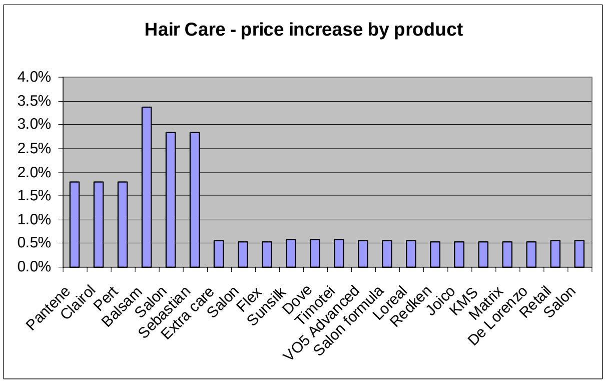
Modelling Effects of the Merger

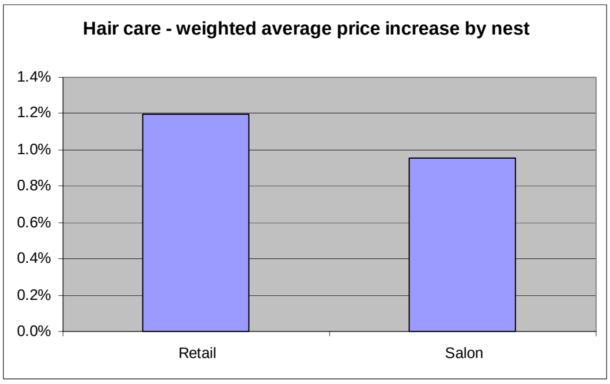
175. The highly differentiated nature of the pertinent markets suggests that it is appropriate to use the Commission's PCAIDS merger simulation software. The software generates indicative price changes that might occur through an increase in unilateral market power due to a merger. It was first used in Decision 482, where it is described in the following terms:

> *Diversion ratio calculations*[6] *… have been incorporated into … software that generates a Bertrand-Nash equilibrium in prices for a given merger.*[7] *This software was developed according to specifications set out in a recent paper by Epstein and Rubinfeld.*[8] *In the paper, they propose a technique based on Deaton and Muellbauer's "Almost Ideal Demand System" (AIDS)*[9] *that is calibrated by market shares. Hence it carries the moniker, Proportionality Calibrated AIDS or PCAIDS.*

176. The model was set up and run for all three markets. Details of inputs required by the model are set out in Appendix 2. In all of the markets concerned, products appeared to be priced and marketed quite differently depending on the type of distribution channel where the product is sold. Accordingly, products were nested according to whether they are sold through supermarkets, pharmacies or salons.

177. The modelling indicates that certain products in the hair care market may profitably be increased in price by more than two percent. However, on a weighted average basis prices are predicted to increase by about one percent in both supermarket and salon nests. In general, price increases are more pronounced for products of the merging entities due to the "internalising", after the merger, of losing customers from one of their brands to another of their, ex-post, increased stable of brands.





178. Again, some products in the rather crowded hair styling market might profitably be increased in price by about three percent. However, on a weighted average basis prices are predicted to increase by less than one percent in both supermarket and salon nests.

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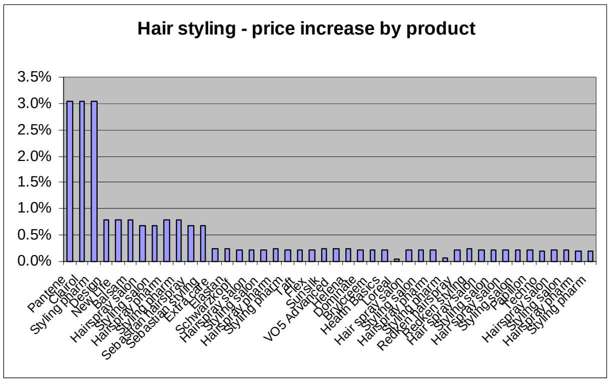
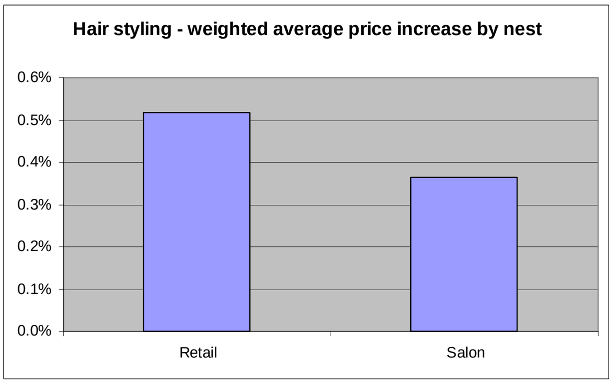
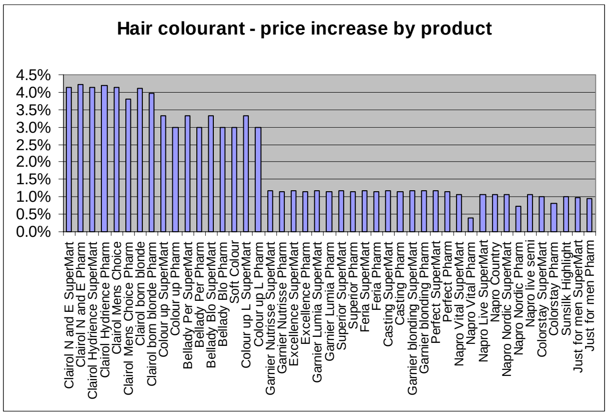
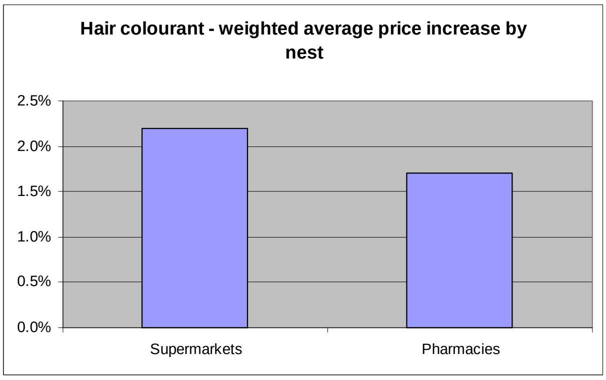
[6] See Carl Shapiro, "Mergers with Differentiated Products", *Antitrust Law Journal*, spring 1996, pp. 23-30.
[7] For a full exposition see Jean Tirole, *The Theory of Industrial Organization*, Harper Collins, 1988, chapter 7.
[8] Roy Epstein and Daniel Rubinfeld, "Merger Simulation: A Simplified Approach With New Applications", *Antitrust Law Journal*, vol. 69, pp. 883-919.
[9] Angus Deaton and John Muellbauer, "An Almost Ideal Demand System", *American Economic Review*, June 1980, pp. 312-26.





179. The simulation run for the hair colourant market suggests that some products might be increased in price by up to four percent. This is larger than for the care and styling markets due to the somewhat greater concentration in the colourant market and the lower elasticity figure used. On a weighted average basis, prices are predicted to increase by about 2 and 1.5 percent in supermarket and pharmacy nests respectively.





180. The modelling work suggests that, while prices may rise up to 4% for some products, the weighted average price rise in any of the markets will be no more than 2.5%. It is noted that these results are subject to the assumptions of the PCAIDS model (see Decision 482) and the quality of the data supplied.

181. It should also be noted that the model is based on an assumption of no entry. It therefore shows that existing competition is such that even without entry, prices may only increase by a small percentage after the merger, thus verifying the Commission's analysis as set out above. The Commission, however, is of the view that entry barriers are low and entry likely with the result that price increases, if any, would be even less than those predicted by the model.

OVERALL CONCLUSION

182. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the markets for:

- The national supply of hair care products (the hair care market);
- The national supply of hair colourants (the hair colourant market); and
- The national supply of hair styling products (the hair styling market).

(the relevant markets).

183. The Commission considers that the appropriate counterfactual for comparison is the status quo.

184. The Commission has considered the probable nature and extent of any possible lessening of competition in those markets in terms of the competitive constraints that would exist following the merger from:

- Existing competitors; and
- Potential competitors.

185. The Commission has also considered whether the proposed acquisition would be likely to enhance the scope for coordinated market power in each of the markets.

186. The Commission has concluded that the merged entity would be constrained from exercising market power in the relevant markets by both existing and potential competitors.

187. The Commission has also concluded that the proposed acquisition is unlikely to enhance the scope for coordinated market power in the relevant markets.

188. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the relevant markets.

DETERMINATION ON NOTICE OF CLEARANCE

189. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition of Wella New Zealand Limited by Proctor and Gamble Distribution New Zealand Limited.

Dated this day of 2003

MJ Belgrave

Chair

APPENDIX 1

Main Brands in New Zealand

Hair Care

Supplier	Retail Products	Salon Products
P&G	Pantene	
	Clairol Herbal Essences	
	Pert	
	Head & Shoulders	
Wella NZ	Wella Balsam	Wella Salon Professional
	Free & Lovely	Sebastian
Unilever	Sunsilk	
	Dove	
	Timotei	
	Fruitrience	
	Rexona Essentials	
Schwarzkopf	Extra Care	Osis
		Silhouette
		Bonacure
Colgate	Palmolive	
L'Oreal		L'Oreal Professional
		Kerastase
BDM Grange	Advanced VO5	
	Andrew Collinge	
	Alberto Salon Formula	
	Tresemae	
Helena	Helena	
Johnson & Johnson	Neutrogena	
Revlon	Flex	
	ZP II	
Others		Paul Mitchell
		Joico
		Redken
		KMS
		Others

Colourants

Supplier	Retail Products	Salon Products
P&G	Nice N Easy	
	Hydrience	
	Loving Care	
	Glints	
	Natural Instincts	
Wella NZ	Bellady	

	Colour Up	
	Wella Soft	
	Effects	
	Viva	
L'Oreal	L'Oreal Preference	
	L'Oreal Excellence	
	Garnier Nutrisse	
	Recital	
	Castings	
	Garnier Feria	
	Blonding	
Schwarzkopf	Live Colour	
	Country Colours	
	Vital Colours	
	Nordic	
	Napro	

Hair Styling

Supplier	**Retail Products**	**Salon Products**
P&G	Pantene	
	Herbal Essences	
Wella NZ	Wella Balsam	System Professional
	Design	Sebastian
	New Life	Delva
		High Hair
		Works
L'Oreal	L'Oreal	L'Oreal Professional
		Kerastase
Schwarzkopf	Taft	Osis
		Silhouette
		Bonacure
BDM Grange	Andrew Collinge	
	Advanced VO5	
Others		Paul Mitchell
		Joico
		Redken
		KMS
		Others

APPENDIX 2

Modelling Effects of the Merger

1. The model used was the Commission's PCAIDS merger simulation software. The software generates indicative price changes that might occur through an increase in unilateral market power due to a merger.

2. The model requires as inputs the following:

    - brand market shares (as measured by revenue);
    - the market price elasticity of demand;
    - the own price elasticity of demand of one of the brands in the market; and
    - attribution of brands to different "nests" to reflect a degree of substitutability between groupings of brands that is considered to be warranted but is not reflected in the market share data.

    There is a further option to include estimates of post-merger efficiency gains that are likely to be achieved.

3. The inputs to the model in this case were developed as follows. Total revenue brand market shares were derived from the same data sources as for market share data presented earlier. There seems to be little information on market elasticity for the products in this case however Epstein and Rubinfeld in their article suggest that in the absence of independent estimates of market demand elasticity, a conservative approach is to use -1. This figure is used in the simulation for the hair colourants market and a figure of -1.2 is used for the styling and care markets which the Commission considers are likely to be somewhat more elastic. Some products with very small market share have been combined with others or excluded.

4. The own price elasticity for a single brand was estimated using time-series supermarket data for price and quantity sold measured as the arc price-elasticity for discrete changes in price. These arc elasticities seemed to be relatively consistently between -6 and -7 and so an own price elasticity of -6.5 was adopted for the purposes of the modelling.

5. As discussed above, in all of the markets concerned, products appeared to be priced and marketed quite differently depending on the type of distribution channel where the product is sold. Accordingly, products were nested according to whether they are sold through supermarkets, pharmacies or salons.

6. It has been suggested to the Commission that there is likely to be some rationalisation in the New Zealand distribution channels should the acquisition proceed. This does indeed seem likely, especially for those Wella NZ products sold through supermarkets. The Applicants were given opportunity to demonstrate that this might be the case but did not provide a sufficient basis for staff to estimate such cost efficiencies. Accordingly none were included in the model inputs although, given the apparent scope for costs to be reduced, this may be a conservative position.

7. Model runs using these parameters were made for each of the markets. For the hair care and styling markets, products were assigned to either of a salon or supermarket (retail) nest. Pharmacies play only a minor role in this market and the effects of the transaction are likely to be adequately captured, and certainly more clearly presented, without pharmacy figures. For the hair colourant market pharmacies sell approximately one third of the product by value while salons do not typically sell hair colourant products at all. Accordingly, for the purposes

of modelling, colourant product shares have been put into either of a pharmacy or supermarket nest.