



COMMERCE COMMISSION

Decision No. 564

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

ESSILOR NEW ZEALAND LIMITED

and

PROLAB (WELLINGTON) LIMITED

The Commission: David Caygill
Peter JM Taylor
Anita Mazzoleni

Summary of Application: The acquisition by Essilor New Zealand Limited of all shares in Prolab (Wellington) Limited.

Determination: Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.

Date of Determination: 23 November 2005

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EXECUTIVE SUMMARY

1. Essilor New Zealand Limited (Essilor) sought clearance to acquire all shares in Prolab (Wellington) Limited (Prolab). At the same time, in a separate Application, Essilor also sought clearance to acquire up to 100% of shares in Optical Laboratories NZ Limited. That second Application is dealt with in Decision 565.
2. The Commission may grant clearances for acquisitions under section 66 of the Commerce Act where it is satisfied that the proposed acquisition would not be likely to result in a substantial lessening of competition in a market.
3. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines. The analysis involves defining the markets, then assessing the difference between the likely outcomes with and without the acquisition. This approach enables the Commission to properly assess the likely extent of competition should the acquisition proceed compared to the extent of competition if the acquisition did not proceed. The Commission assesses the various possible competitive constraints – existing competition, potential competition and/or countervailing power of buyers or suppliers – and determines whether the Commission can be satisfied that the difference is such that the acquisition would not have, or would not be likely to have, the effect of substantially lessening competition.
4. The relevant markets are the national markets for the:
 - import and intermediate supply of blank prescription lenses; and
 - wholesale supply of processed prescription lenses.
5. Under the factual the acquisition of Prolab would lead to:
 - increased horizontal aggregation in the national market for the wholesale supply of processed prescription lenses; and
 - increased vertical integration between the upstream level of importation and intermediate supply of blank prescription lenses, and the downstream level of the wholesale supply of processed prescription lenses.
6. The Commission considers that the appropriate counterfactual is that Prolab would continue to operate as a lens processing laboratory in the immediate future. Consequently, the status quo would continue.
7. Market participants informed the Commission that the processed lens market is highly competitive and there are many firms that optometrists could switch to in the event of the combined firm decreasing quality of product and service, or raising its prices. In particular, wholesalers of processed lenses confirm they have large spare capacity at present, and could expand quickly and easily if the opportunity presented itself. Optometrists also have the potential to source processed lenses from Australia. Potential entry may also be likely, although this appears to depend on the new operator having sufficient expertise. Accordingly, the Commission considers that there is unlikely to be a substantial lessening of competition in the national market for the wholesale supply of processed prescription lenses.
8. The key vertical integration issue is whether Prolab would be foreclosed to those other blank lens importers who do not have processing laboratories in New

Zealand. Consequently, optometrists may lose access to the types of brands supplied by the non-vertically integrated blank lens importers.

9. Market participants informed the Commission that, unlike most other industries, the lens processing laboratories (wholesale level) are dictated to by the optometrists (retail level) in terms of the types and brands of lenses they supply. Optometrists decide what brand to use (and therefore what supplier), not the laboratory. This unusual characteristic of the processed lens market leads to the situation where all processing laboratories, including vertically integrated ones like Essilor and Sola (except Hoya), carry a range of their competitors' blank prescription lenses. They do this or risk missing out on a sale to another processing laboratory.
10. However, even if the combined firm elected not to stock competitors' blank lenses, the likes of Gerber and Younger still have other wholesalers/processing laboratories they could sell to. These laboratories include Sola, Lensbiz, OPSM, Universal Lens, and Read. Accordingly, the Commission does not consider the increase in vertical integration raises any substantial competition issues.
11. Therefore, the Commission concludes that the proposed acquisition is unlikely to give rise to a significant lessening of competition in the national markets for the:
 - import and intermediate supply of blank prescription lenses; and
 - wholesale supply of processed prescription lenses.
12. Accordingly pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition by Essilor of all the shares in Prolab.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 10 October 2005. The notice sought clearance for the acquisition by Essilor New Zealand Limited of all shares in Prolab (Wellington) Limited.

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 24 November 2005.
3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 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 approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission may grant a clearance for an acquisition where it is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in a market. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
6. The Commission considers that it is necessary to identify a real lessening of competition that is not minimal.³ Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis, the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.
7. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, 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.

ANALYTICAL FRAMEWORK

8. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

³ See *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:

- with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).
9. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:
- existing competition;
 - potential competition; and
 - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Essilor New Zealand Limited

10. Essilor New Zealand Limited is a wholly owned subsidiary of Essilor International S.A., a listed French company. It manufactures spectacle lenses overseas, and is a wholesaler of processed spectacle lenses. Essilor started its operations in New Zealand in 1998, and has various processing laboratories throughout New Zealand. It imports unprocessed blank lenses into New Zealand to supply lens processing laboratories, including its own.
11. Essilor is a holding company of the following companies:
- a) Essilor Laboratories (NZ) Limited (wholly owned). This is the Essilor group subsidiary operating as a lens processor, undertaking, in particular, the edging and fitting of lenses.
 - b) Vision Web New Zealand Limited (wholly owned). This is a non-trading entity.
 - c) Xtra Vision Limited (wholly owned). This is also a non-trading entity.
 - d) Direct Optical Supplies Limited (wholly owned). This is the Essilor group company that supplies unprocessed and semi-processed lenses to Essilor Laboratories (NZ) Limited as well as other laboratories, excluding Hoya (Hoya's laboratory by choice processes only Hoya lenses).
 - e) Optical Laboratories NZ Limited (20% owned). This is a Christchurch-based lens processing laboratory. The other 80% shareholding is held by the executors of the late Mr and Mrs Turner, who previously managed the day to day operation of Optical Laboratories NZ Limited.

Prolab (Wellington) Limited

12. Prolab (Wellington) Limited is a Wellington based company, owned by predominately practicing and/or retired optometrists. Prolab is solely an optical laboratory lens processor which grinds, coats, edges and fits processed lenses.

13. Prolab is a holding company of the following companies:
 - a) Prolab Limited (wholly owned). This is a non-trading entity; and
 - b) Professional Optical Laboratory (wholly owned). This is a non-trading entity.

INDUSTRY BACKGROUND

Blank prescription lenses

14. Most lenses are made from glass or plastic. Plastic lenses are divided into two groups: thermosetting plastics and thermoplastic (polycarbonate). Industry participants informed the Commission that the majority of lenses sold in New Zealand are plastic, and that glass lenses make up only a small proportion of lenses sold.
15. In their basic form, prescription lenses come in three main types known as 'blanks': single-vision lenses, bifocal lenses and progressive lenses. The type of lens correlates to particular visual requirements of the patient.
16. Almost all single-vision lenses are stock lenses in that they cover very common long or short-sightedness problems. In other words, single-vision stock lenses can be worn by a customer immediately, (after these are fitted in a frame) without the lens needing to be 'ground' by a machine or 'coated', a substance that gives the lens a polished appearance, and prevents scratching and smudging. Stock lenses can be sold directly from the lens manufacturers to optometrists who have tracing, cutting and fitting facilities on their premises. These optometrists tend to carry these types of lenses in stock. Those optometrists without tracing, cutting and fitting facilities purchase stock lenses through one of the processing laboratories who then complete the lenses by tracing, cutting and fitting the lenses to frames.
17. A small proportion of single-vision lenses require further grinding to suit optical conditions that fall outside the common long and short-sightedness problems that stock lenses cover. Bifocal and progressive lenses are known as semi-finished lenses, although these lenses can be regarded as blanks that will need to be ground by machine to particular dimensions according to a person's prescription.
18. Lens manufacturers supply all types of blank lenses to prescription lens processing laboratories. No blank lenses are manufactured domestically: all lens suppliers import them into New Zealand from their overseas factories. The current main suppliers to New Zealand are Essilor, Sola, Hoya, Gerber Coburn, Younger Optical and Rodenstock.

Prescription lens processing laboratories

19. Prescription lens processing laboratories process blank lenses into finished lenses according to a specific prescription. They grind and surface (edge and polish) lenses and integrate tinting, scratch-proofing, anti-reflective and smudge-proofing. They can also fit lenses to frames.
20. Some optometrists employ a dispenser on the premises to perform their own fitting: the exact number of optometrists that do this in New Zealand is not

available. Prescription lens processing laboratories also act as wholesalers as they sell the finished processed lenses to optometrists.

Optometrists

21. In New Zealand there are over 500 registered optometrists. A large majority of them are independent practitioners who operate their own facilities, and can deal with what laboratories or lens suppliers they wish.
22. Approximately 110 optometrist practices are part of the Visique group, a franchise type of operation. Members of the Visique group have a supply agreement with Essilor which provides that if they use []
23. OPSM employs optometrists to work in its national chain of stores. It has approximately 30 stores throughout New Zealand. OPSM supplies finished lenses fitted in frames to the public. []

]]

MARKET DEFINITION

24. 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."⁴
25. For the purpose of competition analysis, the internationally accepted approach is to assume the 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 would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of a market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market

26. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.
27. 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.
28. 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 to their relative prices.
29. The Applicant submits there are two relevant product markets for this proposed acquisition:

⁴ s 3(1) of the Commerce Act 1986.

- the manufacturer/lens casting market; and
- the ophthalmic lens processing market.

Blank Prescription Lenses

30. The Applicant submitted that prescription lenses are substitutable for contact lenses, and more distant substitutes are ready-made spectacles and laser surgery. However, the Applicant acknowledges that optometrists do not regard contact lenses, ready-made spectacles and laser treatment as substitutable.
31. Industry participants informed the Commission that people tend to purchase contact lenses to complement their prescription lenses. The eye must have oxygen so most optometrists advise their clients that they should not wear contact lenses continuously, and instead should balance their use of contacts with use of spectacles. Further, usage of contact lenses is more limited than spectacles as some optical conditions are not suitable for contact lenses.
32. In terms of ready-made spectacles, market participants informed the Commission that these are generic non-prescription lenses. They are very basic stock lenses mass produced mainly by factories in China, fitted to frames and sold through retail outlets like The Warehouse and pharmacies. Optometrists informed the Commission that they do not sell ready-made spectacles and would not substitute them for prescription lenses in their practices.
33. Some people use ready-made spectacles rather than prescription lenses and frames, mainly for reasons of price as ready-made spectacles are a far cheaper option. However, these types of ready-made spectacles are regarded by industry participants more as reading aids rather than corrective lenses, and are not customised to the individual. Further, the range of ready-made lenses is very limited and will not be of any assistance to many types of optical conditions. Overall, however, the Commission accepts that there is some demand-side substitution between ready-made spectacles, and prescription lenses and frames for some end-users with very basic short or long sightedness.
34. In terms of supply-side substitution, contact lenses are made by completely different machinery. Ready-made lenses, on the other hand, can be produced by the same machinery as blank prescription lenses with some minor adjustment. However, the main suppliers to the New Zealand market choose not to do this, instead tailoring their operations to specialise in producing blank prescription lenses only.
35. Overall, the Commission considers that while there is some demand-side substitution between prescription lenses and contact lenses, it is modest. Further, while some end-users with basic short or long-sightedness may substitute ready-made lenses for prescription lenses, those types of lenses cannot be used for more advanced optical conditions, suggesting that while there is some demand-side substitution, it is limited. There is no supply-side substitution between contact lenses and prescription lenses, although there is supply-side substitution between ready-made lenses and prescription lenses.
36. The Commission considers that while there is some competition at the margins, contact and ready-made lenses do not compete in the same market as

prescription lenses. The Commission therefore considers that the relevant product market is blank prescription lenses.

Geographic Dimension

37. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.
38. The Applicant submits that the relevant geographical market is national.
39. None of the suppliers of blank prescription lenses manufacture them in New Zealand. They import them from their overseas factories, the majority of which are in Australia. They supply the lens processing laboratories and optometrists directly, and there is no price difference between regions.
40. Accordingly, the Commission considers the relevant geographic market for blank prescription lenses to be national.

Functional Dimension

41. The production, distribution and sale of product typically occur through a series of functional levels, conventionally arranged vertically in descending order. Generally, the Commission identifies separate relevant markets at each functional level affected by an acquisition, and assesses the impact of the acquisition on each.
42. As mentioned above, no lens blanks are manufactured in New Zealand: all lens blanks are imported. The blanks are then sold to the lens processing laboratories. Hence the relevant functional level is the importation of lens blanks.
43. Importation is not the only relevant functional dimension given that some lens importers also have lens processing laboratories. For instance, Essilor and Sola not only supply blank prescription lenses to prescription lens processing laboratories, the two firms also have their own processing laboratories, and so supply their own laboratories with their own blank lenses. To ensure they have the full range that optometrists demand, the two firms also stock and process other manufacturers' lenses.
44. Hoya manufactures its own blank lenses overseas and supplies them to its Australian prescription lens processing laboratory, then sells them to New Zealand optometrists. Unlike Essilor and Sola, it does not stock and process non-Hoya lenses.
45. Gerber Coburn and Younger Optics manufacture and supply blank prescription lenses to prescription lens processing laboratories only. Unlike the other blank lens suppliers, they do not have prescription lens processing laboratories.
46. To adequately capture these differences in supply, the Commission considers the appropriate functional levels are the import and intermediate supply of blank prescription lenses.

Blank Lenses Conclusion

47. Accordingly, the Commission concludes that the appropriate market is the national market for import and intermediate supply of blank prescription lenses.

Processed Lenses

48. Optometrists informed the Commission that the only way to purchase processed lenses is from a lens processing laboratory. Some large optometrist practices have a dispenser on the premises who cuts the lenses and fits them to frames. This requires two pieces of equipment: a tracer and an edger. For all other aspects of the process, the optometrists use lens processing laboratories. The majority of optometrists in New Zealand are sole practitioners without facilities to cut and fit lenses. Consequently, they rely on lens processing laboratories for the entire processing and fitting of the lenses. Overall, there appears to be limited demand-side substitution.
49. A typical lens processing laboratory has the following machinery:
- Blocker
 - Grinding machine
 - Surfacing machine
 - Polisher
 - De-blocker
 - Tracer
 - Edger
 - Coater
50. A processing laboratory operates very much like a production line, and each machine performs a different function in the overall processing activity. In terms of supply-side substitution, this lens processing machinery is highly specialised and cannot be substituted.
51. Given that there is no demand-side or supply-side substitution, the Commission considers that processed prescription lenses forms a discrete product market.

Geographic

52. The Applicant submits that the relevant geographical market is national.
53. Processing laboratories informed the Commission that they have customers across New Zealand, and that freighting costs are minimal given the lightweight nature of lenses.
54. Some told the Commission that local optometrists will use local laboratories because of longstanding relationships, and sometimes to ensure a quick turnaround. However, most industry participants confirmed that delivery times across New Zealand, and even from Australia to New Zealand are fairly similar.
55. Overall, the Commission is satisfied that geographical market for processed prescription lenses is national.

Functional

56. Blank prescription lenses are processed by the lens processing laboratories and then sold to the optometrists. In a sense, processing laboratories are processors who are also wholesalers.
57. The Commission considers the correct functional level is the wholesale supply of processed prescription lenses.

Processed Lenses Conclusion

58. Accordingly, the Commission concludes that the appropriate market is the national market for the wholesale supply of processed prescription lenses.

Conclusion on Market Definitions

59. The Commission concludes that the relevant markets are the national markets for the:
- import and intermediate supply of blank prescription lenses; and
 - wholesale supply of processed prescription lenses.

COUNTERFACTUAL AND FACTUAL

60. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a “with” and “without” comparison rather than a “before” and “after” comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).⁵ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

61. Should Essilor acquire Prolab, it would [
-]

Counterfactual

62. Prior to Essilor’s approach, Prolab [
-] The Commission considers the most likely counterfactual is the status quo as Prolab would continue to operate in the market in the immediate future.

COMPETITION ANALYSIS

Existing Competition

63. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).
64. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

⁵ Commerce Commission, *Decision 410: Ruapehu Alpine Lifts/Turoa Ski Resorts Ltd (in receivership)*, 14 November 2000, paragraph 240, p 44.

65. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:
- 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 40% share; or
 - 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%.
66. Market shares for the wholesale supply of processed prescription lenses are set out in Table One.

Table One: Market share for the wholesale supply of processed prescription lenses for the year ending May 31 2005.

Firm	Sales Revenue	Share
Essilor	[]	[]%
Prolab	[]	[]%
Combined Firm	[]	[]%
Hoya	[]	[]%
Sola	[]	[]%
Lensbiz	[]	[]%
Read	[]	[]%
Universal	[]	[]%
OPSM*	[]	[]%
Total	[]	100%

*OPSM's figure does not include what Essilor supplies OPSM.

67. Table One indicates that the post-acquisition the three firm ratio concentration is 85% and the combined firm market share is []%, and therefore outside safe harbours. Essilor's figure assumes that Essilor's proposed acquisition of Optical proceeds, and therefore reflects the combined market share of those two firms.
68. The Applicant submitted that the combined firm would be constrained by existing competition, primarily because: "All competitors are operating well under their productive capacity; accordingly they could easily increase their operations to supply any optometrist dissatisfied with the 'merged' entity's service."
69. Although the market share of the various competitors appears relatively modest, market inquiries confirmed that Essilor's competitors are in fact a large constraint and would continue to be so post-acquisition. More specifically, Sola and Hoya are the largest constraints, although the Commission notes that Hoya is a more limited constraint than Sola given it sells its own lenses only. Both are vertically integrated firms that have large processing facilities overseas. Hoya processes all of the lenses it wholesales in New Zealand in its Australian laboratory. Sola has a full processing laboratory [] in New Zealand.

70. There are various reasons as to why Essilor appears to be the preferred processing laboratory for the majority of optometrists. As mentioned above, Essilor has a supply agreement with Visique optometrists []
71. Some optometrists told the Commission that Sola's and Hoya's [] but they choose to deal mainly with Essilor for a variety of reasons. Some said given that Essilor had a full processing laboratory (including a multi-coating machine) in New Zealand, optometrists could get a quicker turnaround. They could get the complete job done in New Zealand, whereas if they wanted multi-coating from one of the other major laboratories they would have to wait longer as the lenses would need to go off-shore for the final multi-coating process.
72. However, the majority of industry participants said that delivery times between New Zealand and Australia were similar. Some said they even had faster service from Australia, whereas other optometrists told the Commission that sending lenses to Australia for processing took one or two days longer than having them fully processed locally. Another optometrist said that it was less convenient to deal with Australian processors because if the lenses were incorrect, there would likely be time delays in having to send them back to Australia.
73. Sola told the Commission that it regarded other processors in Australia as competitors, and that the largest emerging competitor was processing laboratories in Asia, as they could employ cheap labour to work continuously on shifts. In terms of the time factor, Sola told the Commission that Hong Kong could service New Zealand in the same time that Sydney could service New Zealand, given daily flights.
74. One factor in the optometrists' decision to use Essilor more than other processors could be partially attributable to a loyalty rewards point scheme in which optometrists can redeem points for goods and overseas travel. While some optometrists themselves discounted this, nearly all of Essilor's competitors point to the loyalty reward scheme as a strong incentive for optometrists to use Essilor.
75. However, the optometrists' willingness to use Essilor after the acquisition would be likely to change should the combined firm decrease quality of service or product, and/or raise price to an unacceptable level. Optometrists told the Commission that they considered that processing laboratories competed heavily for their business, and that optometrists commonly used a number of different processors. Some optometrists said they often played the firms off against one another to get either better service or price. Others who used Essilor exclusively said that should the combined firm start raising prices and turnaround times, or decreasing the quality of service, they would not hesitate to go to Hoya, Sola, or smaller laboratories.
76. Market participants told the Commission they used the smaller processing laboratories largely on the basis of personal relationships and reputation for quality of work. Others used the smaller local processing laboratories because they considered delivery times are sometimes shorter.

77. There are currently at least nine large to medium lens processing laboratories servicing New Zealand. Large laboratories can process up to 200 pair of lenses daily, whereas the smaller ones can process approximately 60-100 pairs. Both Sola and Hoya confirm they have sufficient capacity to service the New Zealand market. The smaller laboratories also confirmed that they are presently operating under capacity at the moment, and are able to increase production, quickly and easily, should that be required.
78. Overall, existing competition appears strong given that most firms are operating under capacity. This means they are able to accommodate optometrists dissatisfied with the combined firm's price and service. Further, both optometrists and competitors consider it possible to get lenses processed overseas, should the need arise.

Conclusion on Existing Competition

79. The Commission therefore concludes that the proposed acquisition is unlikely to result in a substantial lessening of competition in the national market for the wholesale supply of processed prescription lenses.

Potential Competition

80. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any barriers they might encounter should they try.

Barriers to Entry

81. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of the aggregate barriers to entry into that market. The Commission is of the view that a barrier to entry is best defined as anything that amounts to a cost or disadvantage that a business has to face to enter a market that an established incumbent does not face.
82. The Applicant submitted that there are no real barriers to entry. However, the Applicant stated that new entry is unlikely given the current over capacity present in the market, and that consequently "there is no margin in the market for a new competitor."

83. The followed requirements are necessary to establish a full processing laboratory:
- Equipment:
 - Blocker
 - Grinding machine
 - Surfacing machine
 - Polisher
 - De-blocker
 - Tracer
 - Edger
 - Coater
 - Building/lease
 - Supply of prescription lenses
 - Cost - \$380,000—400,000
84. Equipment is readily available, and there appears to be no resource management difficulties in obtaining a premises or lease.
85. Market participants told Commission that lack of qualified staff could be a problem for anyone attempting to set up a laboratory. However, they also said that a person could be trained to use the equipment without too much difficulty, although the quality of their workmanship may vary.
86. Supply of lenses is not problematic. Not only could a new entrant access lenses from the current New Zealand suppliers, it would also have the option of accessing other off-shore manufacturers. It is arguable that suppliers also currently operating in the lens processing market, like Essilor or Sola, may refuse to stock a new entrant. However, with the exception of Hoya, which processes and wholesales its own product only, the other two vertically integrated parties supply all independent laboratories in New Zealand, as they see it as another outlet to sell their product.
87. The Applicant put the cost of establishing a full laboratory between \$100,000 – \$150,000. However, many industry participants disagreed and put the figure in terms of new equipment closer to \$380,000 – \$400,000. The Commission notes that older second hand equipment may be cheaper, and this could account for Essilor’s low estimate. However, market participants informed the Commission that there is not really a second hand market in the machinery, and that the machinery needs to be purchased approximately every five years to keep up with technological advances. Consequently, it appears that, apart from acquisition of an entire business, as is the case with Essilor’s purchase of Prolab, older second-hand equipment is unlikely to be purchased by a new entrant.
88. Approximately \$350,000 – \$380,000 of the entry costs would be in new machinery, a sunk cost. Overall the sunk costs to enter this market would be high, yet the New Zealand retail market for prescription lenses is growing and expected to continue to do so.

Conclusion to Barriers to Entry

The “LET” Test

89. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:
- Likely in commercial terms;
 - sufficient in Extent to cause market participants to react in a significant manner; and
 - Timely, i.e. feasible within two years from the point at which market power is first exercised
90. Some industry participants considered entry unlikely for the same reasons as the Applicant: that the market is already over supplied. However, the Commission spoke with Lensworx, a new processing laboratory that set up from scratch in June of this year. [
-]
91. In terms of expansion, [
-]
92. The Commission considers new entry likely in commercial terms. The [
-]
93. However, this is only likely to occur if the lens processor has a reputation for quality workmanship and service. Optometrists are unlikely to support a new entrant that does not have a proven track record.
94. A prescription lens processing laboratory could be set up in 3-4 months.

Conclusion on Potential Competition

95. Overall, the Commission considers that potential entry is both possible and likely in the face of a decline in the combined firm’s service or quality or an increase in price. However, such entry is likely only if the lens processor has a pre-existing reputation as a reliable and good quality processor.

Vertical Integration

96. Vertical acquisitions are those that involve businesses operating at different functional market levels in the production of a particular good or service. Where a vertical acquisition also has horizontal implications, the Commission considers each aspect of the acquisition in its own right.
97. The Commission is of the view that, in general, the vertical aspects of acquisitions leading to vertical integration are unlikely to result in a substantial lessening of competition in a market unless market power exists at one of the affected functional levels. Where such a situation is found to exist, the Commission considers whether the acquisition would strengthen that horizontal position, or have vertical effects in upstream or downstream markets, and whether that change would substantially lessen competition.

98. The potential issue under this head is whether Prolab would be foreclosed to those other lens importers who do not have processing laboratories in New Zealand. Consequently, optometrists may lose access to the types of brands supplied by those non-vertically integrated lens importers.
99. Younger Optics and Gerber are lens suppliers not involved in the wholesale level and so rely on processing laboratories as an outlet to sell their product. []
100. However, the acquisitions would not necessarily mean the removal of the two processing laboratories' custom given the unusual characteristic of the industry: with the exception of Hoya, all lens processing labs carry all suppliers' lenses, even those who they compete with. Generally, all lens processors/wholesalers need to carry a range of brands, as optometrists have their own preferences, and if a particular wholesaler/lens processor did not carry a particular brand the optometrist would simply go to another wholesaler. The lens manufacturers market directly to optometrists and so the optometrists are educated well as to the types of brands on offer. Essilor informed the Commission that it carries a wide range of competitors' brands also, and it seems economically rational for it to do so, as it would otherwise miss out on the sale. Therefore, post-acquisition it seems likely that Essilor will continue to stock its competitors' lenses.
101. However, even if Essilor did not, the likes of Gerber and Younger still have other wholesalers/processing laboratories they could sell to. These laboratories include Sola, Lensbiz, OPSM, Universal Lens, and Read. Further, the volume of the lenses they could supply are likely to increase should those wholesalers/processing laboratories increase production in response to demand from the retail level, a likely occurrence should the combined firm decrease quality, price or service.

Conclusion on Vertical Integration

102. The Commission considers that the increase of vertical integration brought about by the proposed acquisition is unlikely to constitute a substantial lessening of competition in the national markets for the:
- import and intermediate supply of blank lenses; and
 - wholesale supply of processed prescription lenses.

OVERALL CONCLUSION

103. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the national markets for the:
- import and intermediate supply of blank lenses; and
 - wholesale supply of processed prescription lenses.
104. The Commission considers the appropriate counterfactual to be the status quo, as Prolab would continue to operate as a processed lens wholesaler in the immediate future.
105. Existing competition in the processed prescription lens market appears strong given that most firms are currently operating under capacity. This spare capacity

means these processing laboratories are able to accommodate optometrists dissatisfied with the combined firm's price and service. Further, both optometrists and competitors consider it possible to get lenses processed overseas, should the need arise.

106. The key vertical integration issue is whether Prolab would be foreclosed to non-vertically integrated blank lens suppliers, like Gerber and Younger Optics. However, the Commission considers this outcome as unlikely given that demand for lens brand and type is driven by optometrists. Essilor presently stocks competitors' brands because of this demand. However, should Essilor elect to no longer stock other suppliers' lens blanks, Gerber and Younger Optics could still sell their lenses through Sola, Lensbiz, OPSM, Universal Lens and Read.
107. The Commission is therefore satisfied that the proposed acquisition would not have, nor be likely to have, the effect of substantially lessening competition in the national markets for the:
 - import and intermediate supply of blank lenses; and
 - wholesale supply of processed prescription lenses.

DETERMINATION ON NOTICE OF CLEARANCE

108. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Essilor New Zealand Limited of all shares in Prolab (Wellington) Limited.

Dated this 23rd day of November 2005

David Caygill
Division Chair
Commerce Commission