



COMMERCE COMMISSION

Decision No. 628

Determination pursuant to the Commerce Act 1986 in the matter of an application for Proposal

CAVALIER CORPORATION LIMITED

and

NORMAN ELLISON HOLDINGS LIMITED

- The Commission:** Paula Rebstock
Denese Bates QC
Gowan Pickering
- Summary of Application:** The formation of a joint venture company by Cavalier Corporation Limited and Norman Ellison Holdings Limited to acquire all the assets of Norman Ellison Holdings Limited and its subsidiaries.
- Determination:** Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed joint venture.
- Date of Determination:** 14 November 2007

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EXECUTIVE SUMMARY

1. On 10 October 2007, the Commerce Commission (Commission) registered a notice from Cavalier Corporation Limited (Cavalier) and Norman Ellison Holdings Limited (Norman Ellison) seeking clearance to form an incorporated company to be held 70% by Cavalier, or an interconnected body corporate of Cavalier, and 30% by Norman Ellison, that would acquire the assets of Norman Ellison, Norman Ellison Carpets Limited, Horizon Yarns Limited, NEC Manufacturing Limited, Carpet Distributors Limited and Norman Ellison Carpets Pty Limited.
2. Cavalier and its subsidiaries are involved in the procurement of wool at the farm gate, the scouring of raw wool, the manufacture of yarn, and the manufacture and wholesale supply of both residential and commercial carpet, and carpet tiles, around half of which it exports. Cavalier manufactures wool carpets, which it sells under its Cavalier Bremworth brand, as well as synthetic carpets which it sells under its Knightsbridge and EnCasa Carpets brands. Cavalier is positioned in the mid to high end of the carpet market.
3. Norman Ellison is a yarn and carpet manufacturer. It has tufting machinery and a yarn spinning plant located in Auckland and it manufactures and supplies a range of residential carpets which it sells under the Norman Ellison Carpet brand. Norman Ellison is primarily focussed on the mid to lower end of the carpet market. It has a subsidiary company incorporated in Australia that distributes both Australian and New Zealand manufactured wool-blend carpets.
4. Norman Ellison is not involved in the scouring of wool or procurement of wool from the farm gate. It obtains scoured wool from New Zealand Wool Services International Limited for its yarn spinning operations.
5. Should the joint venture proceed, aggregation would occur in respect of the manufacture and wholesale supply of carpet in New Zealand.
6. The Commission has considered the likely nature and extent of competition that would exist, subsequent to the proposed joint venture, in the national market for the manufacture/import and wholesale supply of carpet (carpet market).
7. The Commission considers that the relevant counterfactual is the status quo, with the continuation of Norman Ellison as an independent operator.
8. The Commission considers that in the factual scenario, existing competition from other competitors, such as, Godfrey Hirst NZ Limited /Feltex, Victoria Carpets Pty Limited and Irvine International Flooring Limited, would likely place a significant competitive constraint on the combined entity. In addition, there are a number of small, niche competitors in the market who could easily expand their operations to provide greater competition.
9. Furthermore, importers are able to easily expand their operations, and would continue to be able to do so in the factual. In addition, there are low barriers to de novo entry through importation.
10. Accordingly, the Commission considers that the proposed joint venture is unlikely to result in a substantial lessening of competition.

11. Therefore, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any relevant market and accordingly, determines to grant clearance.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 10 October 2007. The notice sought clearance for Cavalier Corporation Limited (Cavalier) and Norman Ellison Holdings Limited (Norman Ellison) to form an incorporated company to be held 70% by Cavalier, or an interconnected body corporate of Cavalier, and 30% by Norman Ellison, that would acquire the assets of Norman Ellison, Norman Ellison Carpets Limited, Horizon Yarns Limited, NEC Manufacturing Limited, Carpet Distributors Limited and Norman Ellison Carpets Pty 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 Applicants. Accordingly, a decision on the Application was required by 23 November 2007.
3. 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

4. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is likely to have the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal would not be likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline the application. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
5. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.³

6. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is more than nominal and not minimal.⁴ 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.

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

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-721.

³ *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, (2004) 11 TCLR 347, Para 42.

⁴ *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

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 ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any give case.
8. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other timeframe as may be appropriate.

ANALYTICAL FRAMEWORK

9. 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 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).
10. 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, in terms of:
 - existing competition;
 - potential competition; and
 - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Cavalier Corporation Limited

11. Cavalier is a publicly listed company that listed on the New Zealand Stock Exchange (as it was then) in 1984. The Cavalier Group comprises Cavalier and a number of subsidiary companies which are collectively involved in the procurement of wool at the farm gate, the scouring of raw wool, the manufacture of yarn, and the manufacture and wholesale supply of both residential and commercial carpet, and carpet tiles. Cavalier exports around half of its carpet, and has four subsidiary companies incorporated in Australia that distribute carpet in the Australian market. Cavalier also has a 92.5% ownership interest in a wool scouring operation, Hawkes Bay Woolscourers Limited.
12. Cavalier manufactures wool carpets, which it sells under its Cavalier Bremworth brand, as well as synthetic carpets which it sells under its Knightsbridge and EnCasa Carpets brands. Cavalier is positioned in the mid to high end of the carpet market.

Norman Ellison Holdings Limited

13. Norman Ellison is a privately owned and operated yarn and carpet manufacturer. It has a number of subsidiaries, including Norman Ellison Carpets Limited, Horizon Yarns Limited, NEC Manufacturing Limited, Carpet Distributors Limited and Norman Ellison Carpets Pty Limited. Norman Ellison has tufting machinery and a yarn spinning plant located in Auckland. It manufactures and supplies a range of residential carpets which it sells under the Norman Ellison Carpet brand. Norman Ellison has a subsidiary company incorporated in Australia that distributes both Australian and New Zealand manufactured wool-blend carpets.
14. Norman Ellison is not involved in the scouring of wool or procurement of wool from the farm gate. It obtains scoured wool from New Zealand Wool Services International Limited for its yarn spinning operations.
15. Norman Ellison is primarily focussed on the mid to lower end of the carpet market.

OTHER PARTIES

Godfrey Hirst NZ Limited /Feltex

16. Godfrey Hirst/Feltex (Godfrey Hirst) is a vertically integrated manufacturer of synthetic and woollen tufted carpets. Godfrey Hirst is owned by the McKendrick family (and their related interests) of Australia.
17. Godfrey Hirst is the sole shareholder of Clifton Wool Scour Limited, a wool scouring operation in Hawkes Bay. Godfrey Hirst also holds 99.99% of the shares in Canterbury Spinners Limited, a wool yarn spinning company with operations in the North and South Islands.
18. In August 2006, the Commission granted clearance for Godfrey Hirst NZ Limited to acquire the assets of Feltex Carpets Limited (*Decision No. 587: Godfrey Hirst NZ Limited / Feltex Carpets Limited*). In October 2006, Godfrey Hirst acquired the assets of Feltex's carpet businesses. Feltex is also a vertically integrated manufacturer in New Zealand, albeit only for wool carpets. It owns and operates a wool scouring plant in Manawatu and several yarn plants throughout New Zealand.
19. Godfrey Hirst has continued to operate the Feltex business as a separate brand in the market, with a separate sales and marketing division to Godfrey Hirst.⁵ Although some of Feltex's manufacturing facilities have been mothballed since being acquired by Godfrey Hirst, Godfrey Hirst and Feltex have, to date, continued to operate from their respective manufacturing facilities, reflecting the fundamentally different manufacturing methods employed by each.
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⁵ However, the Commission notes that for the purposes of the Act, Godfrey Hirst and Feltex are interconnected and thus treated as one head in the market for the purposes of the Commission's analysis.

Victoria Carpets Pty Limited

20. Victoria Carpets Pty Limited (Victoria) is an Australian carpet manufacturer based in Dandenong, Victoria. In addition to its manufacturing base in Dandenong, Victoria also has spinning mills in New South Wales and Queensland. Victoria produces both synthetic and wool carpets and is a major player in the Australian market.
21. Victoria has been active in New Zealand for five years and has based a small sales force here. It supplies both wool and synthetic carpets into the New Zealand market. Victoria has a warehouse facility in Auckland from which it distributes carpet to its New Zealand customers. It also ships some stock directly from its warehouse in Victoria.

Irvine International Flooring Limited

22. Irvine International Flooring Limited (Irvine) is an importer and distributor of carpets and is based in Christchurch. Irvine imports a range of predominantly synthetic carpets for residential and commercial applications.⁶ Irvine commissions manufacturing in several other countries including:
- [] to produce the carpet it imports and sells.

Other Wholesale Suppliers

23. In addition to the above named parties, there are a number of small and/or niche wholesale suppliers who either manufacture or import carpet. Manufacturers include Windsor Carpets Limited (Windsor), Sallee Carpets Limited (Sallee), and Autex Industries Limited (Autex). Importers include Jacobsen Creative Surfaces Limited (Jacobsen), Robert Malcolm Carpet Limited (Robert Malcolm), Beaulieu Carpets Pty Limited (Beaulieu), Northstate Carpet Mills Pty Limited (Northstate), Tuftmaster Carpets Australia (Tuftmaster) and Quest Carpet Manufacturers Pty Limited (Quest).

Carpet Retailers

24. In New Zealand, there are around 400 retail carpet stores, of which some 100 are part of a retail chain, with the remainder being independent stores. Retail carpet chains include: Carpet Court; Hills Flooring, Carpet Barn, Carpet One, Flooring First, and Floorpride.

INDUSTRY BACKGROUND

Carpet Manufacture

25. Carpet is manufactured using wool, wool/synthetic blends, or synthetic yarns using either a tufting or weaving process.
26. Tufted carpet is made by inserting strands of yarn into a woven or non-woven backing using a needling technique, forming loops of tufts at the required length. A latex coating is applied to the reverse side, anchoring tufts in position. A secondary backing is used in the finishing process to add strength and stability.

⁶ Irvine advised that all of its carpets except its Axminster range were synthetic. Axminster carpets only comprise approximately [] % of Irvine's sales.

Tufting machines produce many more metres of carpet per hour than weaving machines, and sit in the low to medium end of the market.

27. Woven carpet is produced on a loom similar to woven cloth. Typically, many coloured yarns are used and this process is capable of producing intricate patterns from pre-determined designs. These carpets tend to sit at the higher end of the market and are very labour intensive to make.

Synthetic and Woollen Carpets

28. New Zealand has historically had a strong affinity with wool carpets. Presently, around 75% of carpets sold in New Zealand are woollen, with the balance being synthetic. However, there has been a recent trend towards synthetic carpets, particularly in commercial applications. Industry participants advised the Commission that they consider that trend will continue in both commercial and residential applications.

Carpet Sales and Distribution

29. Carpet for residential applications is predominantly sold through retailers, who also provide installation services. In respect of carpet for commercial applications, only a small number of retailers sell commercial carpets. Instead, parties such as building project managers or interior designers engage the services of contract suppliers.

PREVIOUS COMMISSION DECISIONS

30. The Commission previously considered markets in the carpet industry in *Decision No.587: Godfrey Hirst NZ Limited / Feltex Carpets Limited* (Decision 587). In that instance, the Commission gave clearance for Godfrey Hirst to acquire some or all of the assets of Feltex. This included a wool scouring plant and four yarn spinning plants. In that decision the Commission defined both a North Island market for wool scouring services and a national market for the manufacture/import and wholesale supply of carpet. The Commission concluded that there was strong existing competition in the national market for the manufacture/import and wholesale supply of carpet, and that carpet retailers held a degree of countervailing power. As Norman Ellison is not active in the scouring of wool, the Commission's findings in Decision 587 in relation to the wool scouring market are not directly relevant to this decision.

MARKET DEFINITION

31. 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.”⁷

32. 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

⁷ S 3(1) of the Commerce Act 1986.

terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a 5-10% increase in price that is sustained for a period of one year.

Product Dimension

33. 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.
34. 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.
35. 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.

Differentiated/Undifferentiated Products

36. Differentiated product markets are those in which the product offering of suppliers vary to some degree and in which buyers make their purchase decision on the basis of product characteristics as well as price. Suppliers' products are imperfect substitutes for one another and less close substitutes impose a lesser competitive constraint than others.
37. In Decision 587, the Commission acknowledged that there was a degree of demand-side substitutability between non-carpet floor coverings and carpet, ultimately the imposition of the SSNIP test meant that they fell outside the product market. In the course of the Commission's present investigation, industry participants confirmed this view.
38. There are a vast number of carpet options available in the market. These variations stem from different manufacturing techniques employed, raw materials used (namely the choice between synthetic or wool), and fibre weight. For example, carpets can be made from polypropylene, polyester, nylon or wool, all of which go to determining the price and quality of the finished product. These various options span a broad spectrum, with no bright line distinction between varying quality and prices. Accordingly, the Commission considers that consumers face overlapping substitutable 'bands', such that it is appropriate to define a single differentiated product dimension.
39. Chris Ogden, Chief Executive Officer of Carpet Court, advised the Commission that in choosing a particular carpet, customers' first priority is colour, closely followed by style and then price.⁸ While agreeing that customers are concerned with colour, other industry participants considered that customers' purchasing decisions are largely driven by price.
40. As noted above, there are a number of variables in the production process which results in the many and varied types of carpets supplied to the New Zealand market. This culminates in a broad price spectrum with carpets of the lowest quality priced (at retail) from less than \$30 per lineal metre⁹ and those at the opposite end of the spectrum priced at \$450 per lineal metre. The Commission

⁸ This view was also shared by other industry participants such as Godfrey Hirst and Carpet Barn.

⁹ A lineal metre is equivalent to 3.66m² (1m x 3.66m).

remains of the view that, whilst a customer wanting a high quality residential carpet product is unlikely to consider a cheap, low quality synthetic carpet, there nonetheless remains a range of carpets at various price points to which the customer could switch.

41. In light of the fact there have not been any material changes to either the products or pricing of carpet since Decision 587,¹⁰ the Commission considers that, for the purpose of assessing the competitive effect of the proposed acquisition, the relevant product dimension is a single differentiated market for all carpet types.

Functional Dimension

42. Typically, carpet manufacturers and importers do not sell products directly to end-users, whether they be residential or commercial customers.¹¹ In the case of carpets destined for residential applications, manufacturers supply carpet to retailers who sell to consumers. Manufacturers supply commercial carpets either to retailers or contract suppliers.
43. Accordingly, consistent with Decision 587, the Commission considers the relevant functional dimension of the market to be the manufacture/import and wholesale supply of carpet.

Geographic Dimension

44. The Applicant submitted, consistent with Decision 587, that the relevant geographic market is national in scope. During the course of its investigation, the Commission found no evidence to suggest that an alternative definition of the geographic boundaries of the market was warranted.¹²
45. Therefore, the Commission considers the relevant geographic dimension to be national in scope.

Conclusion on Market Definition

46. The Commission concludes that the relevant market is a differentiated national market for the manufacture/import and wholesale supply of carpet (the carpet market).

COUNTERFACTUAL AND FACTUAL

47. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).¹³ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

¹⁰ Lyn Chappell, Managing Director, Sallee Carpets advised the Commission that Sallee had not observed any discernible changes in the market since Godfrey Hirst acquired Feltex in October 2006.

¹¹ The Applicants advised the Commission that in 1995 Norman Ellison attempted to sell carpet directly to consumers, which was met with sufficient resistance from its retailers that it abandoned the attempt.

¹² Windsor advised that 1/3 of its supply went to the upper North Island, another 1/3 to the lower North Island, and the final 1/3 to the South Island. Godfrey Hirst also advised that carpet was relatively freight efficient throughout New Zealand.

¹³ *Air New Zealand & Qantas Airways Ltd v Commerce Commission* (No.6), (2004) 11 TCLR 347, Para 42.

Factual

48. In the factual scenario, a newly incorporated joint venture company would acquire all of the assets of Norman Ellison's carpet businesses. Cavalier would hold a 70% interest and Norman Ellison the remaining 30%.

49. [

] [

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Counterfactual

50. Norman Ellison advised the Commission that, absent the proposed acquisition, it would continue to manufacture and supply carpet in New Zealand. Norman Ellison further advised that

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51. The Commission was advised by Norman Ellison that it had considered

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52. Norman Ellison informed the Commission that, in its view, Cavalier was the only likely purchaser of the business. Indeed,

[] in respect of the sale process.

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53. The Commission therefore considers the relevant counterfactual to be the status quo; the continuation of Norman Ellison as an independent operator.

COMPETITION ANALYSIS**Existing Competition**

54. 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).

55. 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.

56. The Commission considers that a business acquisition is 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% and the market share of the combined entity is less than in the order of 40%; 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%.

57. Presently, there are three large manufacturers of carpet based in New Zealand; Cavalier, Norman Ellison and Godfrey Hirst. Other smaller New Zealand based manufacturers include Sallee, Windsor, and Autex. Sallee, Windsor and Autex are all considerably smaller participants than the three large manufacturers and tend to focus on specific niches in the market.
58. In addition to New Zealand based manufacturers, there are also a number of overseas firms that export carpet to New Zealand. Some local manufacturers also import carpet from abroad. In general, the importers do one of three things: import finished broadloom carpets purchased in overseas markets, have carpet contract tufted in overseas markets, or they are an overseas carpet manufacturer with a presence in New Zealand who imports their own product into New Zealand. The Australian manufacturers that fall into this category include Victoria, Beaulieu, and Northstate.
59. The Commission collected market share information from the five main competitors in the market. The market shares for the carpet market (for the year ending 30 June 2007) are set out in Table 1 below.¹⁴

Table 1: Market Share by Value and Volume

| Supplier | Total sales (m²) | % | Total sales (revenue \$) | % |
|--|--|------------|-------------------------------------|------------|
| Cavalier | [] | [] | [] | [] |
| Norman Ellison | [] | [] | [] | [] |
| Godfrey Hirst (inc. Feltex) | [] | [] | [] | [] |
| Victoria | [] | [] | [] | [] |
| Irvine | [] | [] | [] | [] |
| Total | [] | 100 | [] | 100 |

Source: Market participants

60. Table 1 indicates that the combined entity would have a market share by value of []% and the three-firm concentration would be []%. This is outside the Commission's safe harbour guidelines.
61. However, the Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order

¹⁴ As market share data has only been obtained from the five main competitors in the market, it does not take into account all participants supplying to the national carpet market. It should thus be taken as an approximate indication of market share.

to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

62. Sallee advised the Commission that the proposed joint venture would not affect its own business as it does not consider that it competes with either of the applicants. Rather, Sallee is positioned at “the absolute high end” of the market and typically, its customers want unique or custom made carpets. Similarly, Andrew Cunningham, Managing Director of Autex advised the Commission that Autex does not consider that it competes with Norman Ellison in the carpet market as Autex does not supply any residential carpets. Mr Cunningham further noted that due to Autex targeting several price points in the market, it competes with Cavalier only to a limited extent.
63. At least two of the smaller participants considered themselves to be competitors to the Applicants. In particular, Victoria Carpets considered its main competitors in New Zealand to be Godfrey Hirst, Cavalier and Norman Ellison. Such has been its growth over the past five years that it now supplies in excess of []m² of carpet per annum into the New Zealand carpet market. It offers both wool and synthetic carpets in a full colour range.
64. Irvine was also of the view that its main competitors were Godfrey Hirst, Cavalier and Norman Ellison. Like Victoria Carpets, Irvine has also recently experienced considerable growth in the carpet market¹⁵ and now supplies approximately []m² of carpet per annum. Although Irvine does not offer as wide a range as the three large players, Irvine does not consider this to be a disadvantage.
65. Despite the fact that not all competitors in the market are of equal size, Godfrey Hirst considered that it faces competition from Irvine,¹⁶ and both Cavalier and Norman Ellison advised the Commission that they consider Irvine and Victoria Carpets to be amongst their main competitors.
66. A number of Australian manufacturers such as Beaulieu, Northstate, Quest and Tuftmaster, presently have a very small presence in New Zealand. They do not have any operations or personnel in New Zealand. Instead, they distribute through established retailers.
67. Industry participants informed the Commission that there is vigorous competition in the carpet market. In particular a recent increase in imported carpet into New Zealand¹⁷ has enhanced competition in the carpet market, and has resulted in intensified price-based competition, especially in the low to mid segment of the market. This, Godfrey Hirst noted, has resulted in a number of price decreases in the past twelve months. Industry participants considered that this level of competition would continue in the factual scenario.
68. In addition, the largest players in the market have a history of undercutting on price. This practice stems from the importance of economies of scale in manufacturing. In order to maximise economies, Godfrey Hirst, Cavalier and

¹⁵ Mark von Battenberg advised the Commission that in particular the near collapse of Feltex in 2006 had provided importers such as Irvine and Robert Malcolm with an opportunity for growth.

¹⁶ Godfrey Hirst advised the Commission that it had lowered the pricing on its solution dyed nylon carpets supplied into the market in an attempt to prevent Irvine from eroding its market share in respect of these sales.

¹⁷ Trade statistics for the year to 30 September 2007 indicate a total of \$49,127,376 of carpet was imported to New Zealand (approximately 23% of total market value), up from \$42,589,668 (approximately 20.5% of total market value) in the previous year.

Norman Ellison tend to run their manufacturing plants at full capacity. Any excess output is stockpiled, and then ‘dumped’ into the market later, temporarily driving down prices. The players’ profit incentives, and therefore desire for economies of scale, are unlikely to be affected by the proposed acquisition. Therefore, it is reasonable to expect such behaviour to continue in the factual.

Conclusion on Existing Competition

69. The Commission considers that in the factual scenario, existing competition from Godfrey Hirst, Victoria Carpets and Irvine would likely place a significant competitive constraint on the combined entity. In addition, there are a number of very small, niche competitors in the market who could easily expand to provide greater competition.

Potential Competition

70. 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 impediments they might encounter should they try.

Barriers to Entry

71. 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 market conditions that impede entry.
72. None of the industry participants surveyed by the Commission considered that de novo entry as a New Zealand based manufacturer of carpets was likely. Jon Jamieson, Managing Director of Windsor, was of the view that the New Zealand market was too small to support investment in a yarn spinning mill, and, notwithstanding that yarn could be purchased from suppliers such as Summit Wool Spinners Ltd (Summit),¹⁸ the other structural requirements could not be justified, given the small size of the New Zealand market. Rather, nearly all industry participants advised that de novo entry was likely to come from imports.

Imports

73. The Applicants submitted that the combined entity would continue to be constrained by competition from imports. The Applicants further submitted, relying upon Decision 587, that imports are likely to impose even greater competitive constraint in the coming few years due to the tariff reduction programme.¹⁹ In addition, they identified carpet manufacturers in overseas markets, such as the USA and China, as potential entrants.
74. As noted in the existing competition section, there are a number of importers currently involved in the wholesale supply of carpet to the New Zealand market. A significant proportion of these are Australian manufacturers who are

¹⁸ For example, Windsor obtains yarn from Summit which it then tufts at its site in Albany. Similarly, Carpet Barn obtains yarn from Summit, which it then has contract tufted by Sunrise in Victoria, Australia.

¹⁹ The tariff reduction programme will see tariff duty payable on carpet imports progressively reduce from their current level of 15% to 10% in July 2009.

represented in New Zealand,²⁰ with the remainder largely comprised of New Zealand based import businesses who import from a variety of overseas markets.

75. During the course of its investigation, the Commission canvassed a number of New Zealand based and overseas importers on the barriers to entry for imports. They advised the Commission that the main requirements for entry or expansion by existing small-scale/niche importers are:
- access to carpets in ranges and colours, and a level of quality acceptable to New Zealand tastes;
 - sufficient stock to commence supply;
 - a warehousing facility (or arrangement with a warehouse facility); and
 - an agreement with a retailer(s) or a sales force based in New Zealand.
76. [] advised the Commission that there is a surplus of manufacturing capacity in overseas markets and that there are no material impediments to sourcing quality yarns or manufacturing capacity for carpets suitable for the New Zealand market. For example, Irvine has carpet contract manufactured offshore in a diverse range of markets such as []. Carpet Barn also imports contract manufactured carpet in a similar fashion.
77. With the exception of [], who told the Commission that importing was very difficult, industry participants generally advised the Commission that, subject to fluctuations in exchange rates and freight costs, importing, either by way of contract manufacturing or importing finished product, was not a difficult exercise. In particular, they advised that importation from Australia was straightforward and easily accessible. Mark von Batenburg of Jacobsen advised that this was because of the ease of dealing with Australian manufacturers.
78. Several parties advised the Commission that New Zealand has very specific colour requirements. For example, [] stated that carpet colours and styles sold in New Zealand are essentially unique to New Zealand. Whilst Australian importers were also of the view that New Zealand has some specific colour requirements,²¹ they felt that its colour preferences were not so unique as to amount to a barrier to importation. Barry Poynter, Managing Director of Victoria Carpets, also noted that carpets designed for the state of Victoria are largely in line with New Zealand tastes, whereas those designed for Queensland are less suitable. In any event, all of these importers advised that they can add special colours to ranges destined for the New Zealand market without incurring substantial costs.
79. Industry participants also advised the Commission that to be an effective competitor, a carpet supplier needs to hold sufficient levels of stock in New Zealand so as to be able to readily provide retailers with carpet. Industry participants varied in their views as to the breadth of range and colour that would be required to enter the New Zealand market. [] stated

²⁰ The Applicants submitted that Australian carpet manufacturers account for 74% of all carpet imported into New Zealand.

²¹ For example, Neil Verran of Northstate Carpet Mills informed the Commission that whilst Australian colour ranges could be directly transplanted to Auckland, they required 'deepening' for regional areas. In particular, the South Island had a preference for deep reds, blues and greens. This view was also held by Allan Russell of Beaulieu Carpets who noted that New Zealand had a preference for 'heavier, darker colours.'

that in its view a selection of 100 carpets would be required, whereas [] was of the view that five styles, with three to four colours in each would suffice.²²

80. In order to hold stock, an importer would require a warehouse. Victoria Carpets keeps a warehouse stocked in Auckland, and also relies upon stock held in Australia to supply retailers. Carpet Barn also advised that it has a large warehousing facility in which to store stock. In addition, warehouse space can be easily leased, and contract warehousing facilities are also available.
81. As importers only supply through retailers, a key requirement for supply into New Zealand is to gain the support of one or more key retailers. Overall, the vast majority of industry participants were of the view that, given the right commercial incentives, retailers would easily be persuaded to carry an importer's range.²³
82. A few industry participants submitted that some retailers may be reluctant to stock imported carpets for fear of the combined entity retaliating by withdrawing key stock lines. However, this seems an unlikely outcome for several reasons. First, as discussed earlier, economies of scale appear crucial to the profitability of local manufacturers, so withdrawing supply from retailers would not seem a sensible strategy, at least in the short-run. Secondly, there is clear evidence that retailers stock imported product now without facing retaliatory action from local suppliers. Thirdly, Carpet Barn is an example of a retailer that has succeeded in the market by relying exclusively on imported product; Carpet Barn does not rely on any locally-manufactured carpet. Finally, retailers themselves, such as [], submitted that they would be proactive in seeking out overseas supply if they sensed any misbehaviour by local manufacturers.
83. On these grounds, the Commission concludes that access to retail outlets would not be a significant barrier to entry or expansion by carpet importers.

Other Factors

84. Some industry participants noted that Cavalier's *Cavalier Bremworth* range enjoyed very strong brand power. This branding is reinforced by effective marketing conducted by Cavalier and Cavalier's select network of Bremworth dealers. However, aside from the *Cavalier Bremworth* brand, brand is generally not considered a barrier to entry in the market. It is common for retailers to rebrand manufacturers' carpets with their own retail brand and indeed []% of Cavalier's carpets sold in New Zealand are rebranded. Accordingly, the Commission does not consider brand power to be a barrier to entry.
85. Industry participants advised the Commission that there is excess capacity globally for carpet manufacture. In particular, Northstate advised the Commission that due to a building downturn in the USA, there is considerable excess capacity in the USA which would make entry for large US manufacturers, such as Mohawk, attractive should the combined entity seek to take advantage of any market power that it may have.

²² [] estimated that stocking a warehouse with this range of colour and style would cost approximately \$500,000.

²³ For example, Beaulieu supplies to Carlo Flooring, Robert Malcolm Carpets, and Irvines. Willi Hill of Hills Flooring also advised that Victoria had been able to grow through its access to a wide number of independent carpet retailers.

Conclusion on Barriers to Entry

86. Whilst entry through establishing a manufacturing plant is unlikely, the Commission considers that barriers to de novo entry by an importer are low. Supply is readily available and adaptations to colour, if needed, are readily achieved. Requirements such as stock and warehousing are also readily available and the sunk costs involved in entry are minimal. Accordingly, the Commission concludes that barriers to entry by importation are low and that further entry is likely.

Conclusion on Potential Competition

87. The Commission is satisfied that the barriers to entering the carpet market are low and that the threat of entry by importers would likely impose a significant degree of competitive pressure on the combined entity.

Scope for Coordinated Behaviour

88. Following the proposed joint venture, there would be only two major players in the carpet market, Godfrey Hirst and the combined entity. In concentrated markets where expansion by smaller existing players or entry by new players is unlikely, the scope for coordinated behaviour, either explicit or tacit might give the Commission cause for concern.
89. However, as set out in the sections on existing competition above, the Commission is of the view that, in the factual scenario, Godfrey Hirst and the combined entity would likely face a significant degree of competition from a number of existing competitors who are easily able to expand their operations. In addition, the combined entity is likely to be constrained by the threat of new entry.
90. For the above reasons, whilst acknowledging the heightened concentration in the market in the factual scenario, the Commission considers that the scope for coordinated behaviour is unlikely to be enhanced by the proposed acquisition.

OVERALL CONCLUSION

91. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the carpet market.
92. The Commission considers that the relevant counterfactual is the status quo with Norman Ellison continuing as an independent operator.
93. In respect of the carpet market, the Commission considers that, in light of the presence of alternative existing carpet manufacturers and importers, the latter's ability to easily expand, and the low barriers to de novo entry through importation, the proposed joint venture is unlikely to result in a substantial lessening of competition.
94. Therefore, the Commission is satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in any relevant market.

DETERMINATION ON NOTICE OF CLEARANCE

95. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed formation of a joint venture company by Cavalier and Norman Ellison, to acquire the assets of Norman Ellison, Norman Ellison Carpets Limited, Horizon Yarns Limited, NEC Manufacturing Limited, Carpet Distributors Limited and Norman Ellison Carpets Pty Limited.

Dated this 14th day of November 2007

Paula Rebstock
Chair