PUBLIC COPY
ISBN No. 0114-2720
J3853

COMMERCE COMMISSION

Decision No. 383

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

Pacific Dunlop Holdings (NZ) Limited

and

LWR Hosiery and Underwear Limited and R & WH Symington Limited

The Commission: M J Belgrave (Chair)
E C A Harrison

Summary of Proposed Acquisition: The acquisition by Pacific Dunlop Holdings (NZ) Limited of certain assets and businesses of LWR Hosiery and Underwear Limited and R & WH Symington Limited.

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

Date of Determination: 29 February 2000

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THE PROPOSAL

1 On 8 February 2000 the Commission registered a notice from Pacific Dunlop Holdings (NZ) Limited ("Pacific Dunlop") seeking clearance to acquire the following businesses and assets from LWR Hosiery and Underwear Limited ("LWR") and R & WH Symington Limited ("Symington"):

- the manufacturing, sourcing and marketing of hosiery and socks;
- the marketing of men's, women's, and children's underwear;
- the manufacturing, sourcing and marketing of thermal underwear; and
- the assignment of various brands and trade names relating to the above businesses and the benefit of certain licence agreements.

2 LWR will not be transferring its underwear manufacturing business to Pacific Dunlop as it is to be retained by LWR, with a contract for the provision of a manufacturing service to Pacific Dunlop.

THE PROCEDURES

3 Section 66(3) of the Act requires the Commission either to clear or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension of 5 working days was sought by the Commission, and agreed by Pacific Dunlop. Accordingly, a decision on the application is required by 29 February 2000.

4 Pursuant to section 105 of the Act, the Commission delegated its powers to consider and determine the notice seeking clearance to Mr John Belgrave, Chair, and Ms Cathie Harrison, Member, of the Commission.

5 Pacific Dunlop sought confidentiality for certain information contained in the notice seeking clearance, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply to the information.

6 The Commission's determination is based on an investigation conducted by its staff and their subsequent advice to the Commission.

BACKGROUND

The Parties

Pacific Dunlop Holdings (NZ) Limited ("Pacific Dunlop")

7 Pacific Dunlop is an international manufacturing and marketing enterprise, based in Australia. It is engaged in the sourcing, manufacture and marketing of industrial and consumer goods including sporting products, foam products, bicycles, bedding, flooring, footwear, clothing (including underwear and hosiery), and batteries. It is also engaged in automotive and electrical goods distribution.

8 In respect of underwear and socks, Pacific Dunlop has a number of brands in New Zealand. These brands include "Holeproof"(socks), "Underdaks"(men's underwear), "Bonds" (pantyhose), and "Rio" (men's and women's underwear). Pacific Dunlop has no manufacturing plant in New Zealand; its products are imported or manufactured under contract by local manufacturers.

LWR Hosiery and Underwear Limited ("LWR")

9 LWR is a subsidiary of LWR Industries Limited, a private company. A diagram setting out the corporate structure of the relevant companies in the LWR group is attached as Appendix 1.

10 LWR is involved in the manufacture and supply of apparel products throughout New Zealand, from its manufacturing plant in Christchurch. LWR also exports apparel products.

11 Of particular interest to this current proposal is LWR's manufacturing of hosiery, socks, and thermal underwear, and LWR's assignment of various brands and trade names. LWR currently has a number of brands in New Zealand, including "Jockey" (men's and women's underwear), "Gold Top" (socks), "Silks" (pantyhose), and Thermotech" (thermal underwear).

12 As stated earlier, the proposal does not include LWR's underwear manufacturing business.

R & WH Symington Limited ("Symington")

13 Symington is a wholly owned subsidiary of LWR Industries Limited (refer Appendix 1).

14 Symington, based in Palmerston North, is a manufacturer and supplier of thermal underwear that is sold directly into the market. Symington's brands include "Thermatech" and "Liberty".

Apparel Manufacturing

15 The apparel manufacturing industry has undergone significant change in the last decade. Principal factors for the change have been the termination of import licensing and the tariff reduction programme implemented by recent governments.

Tariffs

16 Textiles and apparel were amongst the last product groups to retain import licensing (licensing was removed from textiles in July 1991 and from apparel in July 1992). The import licensing regime covering these products restricted the levels of imported textiles and apparel, and limited the extent to which the industries were exposed to international competition.[1]

17 With regard to apparel, tariffs have been reduced to the current level of 19% and are set to reduce further to 15% on 1 July 2000. The previous government's programme of tariff reduction was to see tariffs remain at 15% until July 2004, then lower to 10% at that date. From July 2005, tariffs were to reduce to 5%, and then to zero with effect

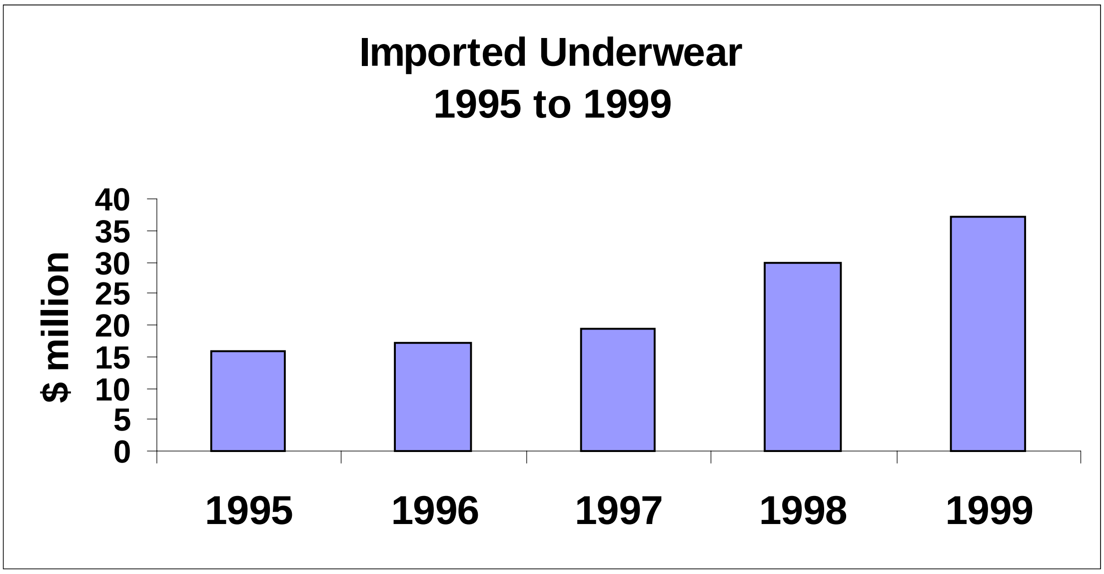
[1] *New Zealand Official Yearbook 1998*, GP Publications, p.449

from July 2006. The current government has not made a statement regarding its tariff policy.

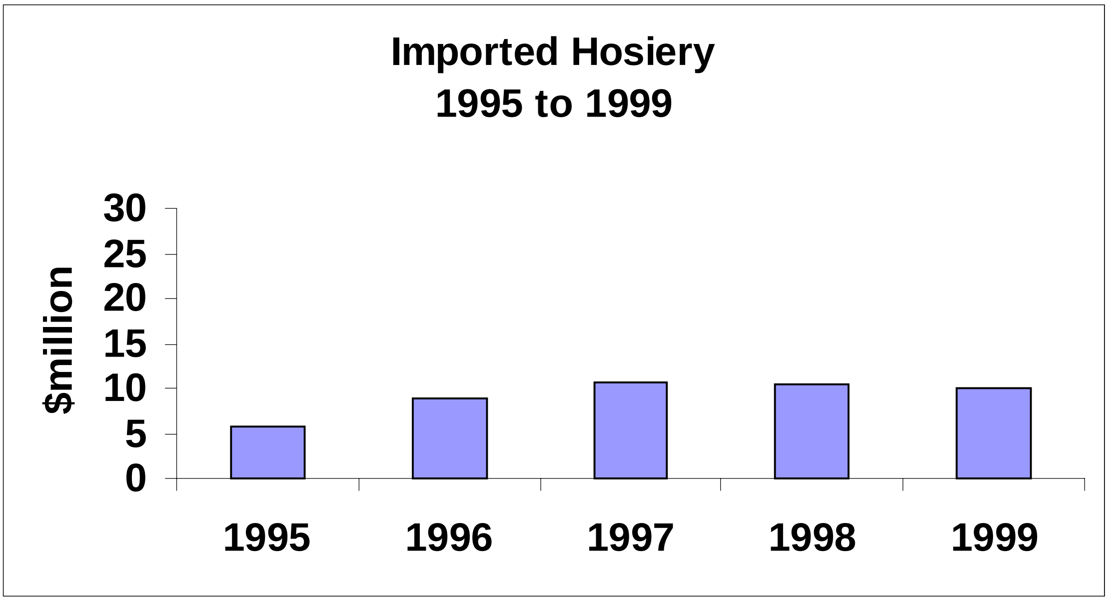
Imports

18 The removal of import licensing and a progressive reduction in tariffs have seen apparel imports from all sources increase significantly in the period 1989 to 1997, from $129 million cif in 1989 to $524 million cif in the June 1997 year. This has lead to considerable rationalisation within the industry, with an accompanying reduction in employment levels.[2]

19 Figures obtained from Statistics NZ show the import trends for underwear and hosiery (socks and pantyhose), and these trends are represented in the tables below (note that the table does not include the importation of t-shirts).[3]



[2] *ibid*
[3] "Underwear" includes men's, women's and children's underwear, slips, petticoats, singlets and vests. "Hosiery" includes men's, women's and children's socks, pantyhose, stockings and tights.



Parallel Importing

20 In 1998, amendments to the Copyright Act 1994 were effected, allowing for "parallel importing". Parallel importing occurs where legally manufactured, copyright products are bought overseas and imported by groups or individuals without permission from the authorised and/or exclusive distributor.

21 Clothing products have been parallel imported into New Zealand recently by major retailers such as The Warehouse and Deka. Industry sources advised that, while parallel importing is available, potential importers are still required to be wary of certain legal obligations such as intellectual property rights (eg. in advertising), and the risk of counterfeit goods.

22 Pacific Dunlop cited recent examples of Farmers Deka importing socks branded "adidas" and "Tommy Hilfiger", as evidence of parallel importing and of the potential for further parallel imported products.

Underwear and Sock Manufacturing

23 The rationalisation of apparel manufacturers, and the increase in imported products, has resulted in a small number of domestic underwear and sock manufacturers. With regard to underwear, the major domestic manufacturer is LWR. A number of "cut, make and trim" operators ("CMT") are present in the apparel industry, though few are involved in underwear manufacturing. Soma President, a CMT operator based in Hastings, provides contract manufacturing services for underwear.

24 There are currently several sock manufacturers in New Zealand. While a number of these manufacturers specialise in a particular range of socks (for example, sports socks or thermal socks) most manufacture a range covering adult, children's, dress and sports socks. Sock manufacturers, including LWR, manufacture their own brands as well as contract manufacturing for major retailers and others.

25 In addition to manufacturing their own branded products, LWR contract manufacture "house brands" for major retailers (see para 28). Typically, contract manufacturing for retailers is not subject to written contracts, and the arrangements may vary from job to job. There is no cost or other barriers to retailers switching suppliers at short notice.

26 LWR and other underwear and sock manufacturers therefore manufacture their own brands, as well as contract manufacturing for retailers and other buyers (such as schools and sports clubs). A number of these manufacturers, including LWR, also import products directly themselves, or on behalf of domestic buyers.

Major Retailers

27 The majority of underwear and sock sales are made through major retail stores in New Zealand, with the balance being sold through specialty clothing stores. The major retailers are national chains such as Farmers, Deka, The Warehouse, and Hallensteins.

28 A relatively new characteristic of the underwear and sock markets in New Zealand is the recent emergence of "house brands". House brands are branded products owned and introduced by the retailers themselves. For example, Farmers markets underwear and sock products under its "More" brand, and The Warehouse sells underwear and socks under the brand name "Class".

29 Industry sources advised that house brands are currently in a "growth" phase, and are well supported by the major retailers. House brands are targeted at the lower to mid-price consumer. Major retailers advised that their house branded products represent a long-term strategic entry into the market, and that house brands will continue to be well promoted by them. House brands are not intended as a short term strategy.

THE RELEVANT MARKETS

30 Section 3(1A) of the Commerce 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.

31 Market definition is a conventional first step in competition analysis. The purpose of defining markets in relation to business acquisitions is to assess the degree of market power which the merged company might gain. As the judgment in the *Queensland Wire Industries* case noted, defining a market and evaluating the power in that market are part of the same process and the two steps are separated "for simplicity of analysis".[4]

32 Markets are defined in relation to product type, geographical extent and functional level. The boundaries of the product and geographical markets are identified by considering the extent to which buyers (or sellers, where supply-side substitution possibilities are being considered) are able to substitute other products, or the same product from other geographical regions, in response to a change in the relative price of the products concerned.

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4 *Queensland Wire Industries Pty Limited* v *Broken Hill Pty Co Limited* (1989) 167 CLR 177.

33 A properly defined market will include products which are regarded by buyers or sellers as being not too different ('product' dimension) and not too far away ('geographical' dimension). In such a market, a hypothetical profit-maximising sole supplier could impose at least a *s*mall yet *s*ignificant and *n*on-transitory *i*ncrease in *p*rice (the *'ssnip'* test) assuming other terms of sale remained unchanged.

34 Market definition principles are further outlined by the High Court in the *AMPS A* case.[5] The Court provided three explanations relating to the method and purpose of market definition. The first was the need to identify relevant areas of close competition. The purpose of this exercise is to identify competitive constraints. The second related to the ways that buyers and sellers would be likely to react to a small percentage increase in the prices of relevant products. The Court emphasised the need to ascertain the cross-elasticities of both supply and demand. The third noted the multi-dimensional nature of markets, namely the dimensions of product, space, functional level and time.

35 The precise boundaries of markets are seldom clear. Often a pragmatic assessment of markets will need to be made. It is important to recognise this when undertaking competition analysis.

Product Market

36 The products that are the subject of this proposal are generally referred to as underwear and socks. In particular, the products are men's underwear, women's underwear, bras, pantyhose, thermal underwear, children's socks, men's socks, and women's socks.

37 Pacific Dunlop submitted that the key determinant of substitutability effectively means that each product constitutes a separate market, in terms of the product dimension of market definition. Pacific Dunlop acknowledged that there may be some substitutability between the markets for men's and women's socks.

38 From a demand side perspective, industry sources agreed that each product was likely to form a separate market, whilst acknowledging that some substitutability did occur. The products that are most commonly substituted are the purchase of men's boxer shorts by women (for wearing as underwear and/or nightwear), and the instance noted above of men's and women's socks.

39 Thermal underwear is a product designed to include heat-retaining properties. Consumers of thermal underwear products (such as thermal vests, t-shirts, and long johns) include trampers, sports people, outdoor workers, and the elderly. The characteristics of thermal underwear, which is manufactured using wool and polypropylene fabrics, are such that consumers are not likely to substitute such products with standard cotton or polyester underwear.

40 From a supply side perspective the products are likely to constitute separate markets. The machinery required for the manufacture of the products is designed for a particular product, and there is no substitutability available. The exception to this, following discussions with industry parties, appears to be men's and women's socks. Socks can be manufactured using the same machinery for men's, women's or children's products (with small adjustments to the patterns and sewing process). These products are also

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[5] *Telecom Corporation of NZ Limited* v *Commerce Commission* (1991) 4 TCLR 473, 502: 3 NZBLC 102,340, 102,362.

supplied through the same distribution channels to similar purchasers, being major retailers and specialty clothing stores.

41 A number of sock manufacturers also advised that they did not distinguish, for accounting purposes, between men's and women's socks, simply referring to "adults" socks. However, children's socks were considered a separate product.

42 Following consideration of both the demand and supply characteristics of the sock markets, the Commission considers that an "adults socks" market is more appropriate than markets defined for men's and women's socks.

43 With the exception of adults socks therefore, the strong demand side characteristics of these products supports separate product markets being defined. Given the above factors, the Commission concludes that the appropriate product markets in this instance are the following:

- men's underwear;
- women's underwear;
- bras;
- pantyhose;
- thermal underwear;
- children's socks; and
- adult's socks.

Function Market

44 Pacific Dunlop has submitted that the merged entity in this case will act as a manufacturer/importer/wholesaler who supplies retailers. Therefore, Pacific Dunlop submits, the appropriate functional level is the wholesale market.

45 Industry sources advised that the traditional "wholesaler" no longer existed with respect to underwear and socks products. There is little evidence of any party performing a wholesaling role, encompassing buying and holding of stock, then distribution to retailers. Rather, manufacturers make and supply products either to a buyer's central distribution centre, or directly into a buyer's stores.

46 It is at this level of the market that imports become a feature. Importers of underwear and socks source supply from an overseas manufacturer either directly or through an agent. The importer also arranges delivery either directly to a retailer's store, or to a specified distribution location. The process is therefore very similar to domestically manufactured and supplied product, and is such that it appears appropriate to combine the manufacturing and supply of products within the one functional level.

47 Given these factors, the Commission considers that the appropriate functional level for consideration of this proposal is that for the manufacture and supply of products.

Geographic Market

48 The manufacture and supply of these products occurs on a national scale. Accordingly, the geographic market is national.

Conclusion on Market Definition

49 On the basis of the analysis above, and on the information available, the Commission considers that the relevant markets for the purpose of analysing the competition issues arising from the proposed merger are the following:

- the national market for the manufacture and supply of men's underwear;
- the national market for the manufacture and supply of thermal underwear;
- the national market for the manufacture and supply of adult's socks.
- the national market for the manufacture and supply of women's underwear;
- the national market for the manufacture and supply of children's socks;
- the national market for the manufacture and supply of bras; and
- the national market for the manufacture and supply of pantyhose.

COMPETITION ANALYSIS

50 Competition analysis assesses competition in the relevant markets, in order to determine whether a proposed acquisition would result, or would be likely to result, in the acquisition or strengthening of dominance. Section 47 of the Commerce Act proscribes a person acquiring the assets of a business or shares where as a result:

> That person or another person would be, or would be likely to be, in a dominant position in a market: or
>
> That person's or another person's dominant position in a market would be, or would be likely to be, strengthened.

51 The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Read in conjunction, sections 66(3) and 47(1) require that, where the Commission is satisfied that a proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not so satisfied, clearance must be declined.

52 Judicial pronouncements set a high threshold for dominance. In his judgment in *Commerce Commission* v *Port Nelson Limited*[6], McGechan J included the following statements[7]:

> 'Dominance' includes a qualitative assessment of market power, It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a high degree of market *control*.
>
> How high? Clearly, not absolute control. There need not be monopoly. There need not be an ability to act totally without regard to competitors, suppliers, or customers….(However), (t)he firm must be able to set terms of trading independently of significant market constraints. It must be able to set prices or conditions without significant constraint by competitor or consumer reaction. (Emphasis in original.)

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[6] (1995) 6 TCLR 406.

[7] Ibid, 441-42. This test was affirmed by the Court of Appeal in *Port Nelson Limited* v *Commerce Commission* (1996) 3 NZLR 554, 573.

53 The Commission's *Business Acquisition Guidelines* also recognise that dominance involves a high degree of market power. The Guidelines reflect that for a firm to be dominant it must have the power to behave in a manner different from that which a competitive market would allow. The *Guidelines* (paragraph 7) state that:

> A person in a dominant position in a market will be able to set prices or conditions without significant constraint from competitor reaction.
>
> A person in a dominant position will be able to initiate and maintain an appreciable increase in price, or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short or long run.

54 As the *Port Nelson* judgment highlighted,[8] the analysis of dominance must centre upon the provisions of section 3(8) of the Commerce Act. In relation to section 47, the relevant provisions are contained in section 3(9). The section requires that regard be had to three groups of factors:

> The share of the market, the technical knowledge, the access to materials or capital of that person or that person together with any interconnected body corporate:
>
> The extent to which that person is constrained by the conduct of competitors or potential competitors in that market:
>
> The extent to which that person is constrained by the conduct of suppliers or acquirers of goods or services in that market.

55 The weight that will attach to each of these considerations will vary from case to case. As Richardson P noted in *AMPS A:*[9]

> (Section 3(9)) does not allow any theoretical or intuitive ranking applicable in all cases. It proceeds on the premise that the weighting must vary according to the particular facts. It calls for a pragmatic assessment in the particular circumstances of one's ability to exercise a dominant influence in one or more aspects of the relevant market.

56 In relation to the present application, seven markets have been identified, which will be effected by the acquisition. In two of these markets, the market for the manufacture and supply of bras, and the market for the manufacture and supply of pantyhose, there will be no aggregation of market share. A competition analysis will not be conducted for these two markets.

Market for the Manufacture and Supply of Men's Underwear

Market Concentration

57 The degree of concentration of market share which would result from a business acquisition is a useful first indication of the likely degree of market power which might follow, and this is recognised in the "safe harbours" that are defined in the Commission's *Business Acquisition Guidelines*. These safe harbours recognise the importance of both the absolute levels of market share, and the distribution of these shares.

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[8] Ibid, 442-43.
[9] *Telecom Corporation of NZ Limited* v *Commerce Commission* [1992] 3 NZLR 429, 444.

58 The *Guidelines* state (paragraph 4.3):

> In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
>
> the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
>
> the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share.

59 Other things being equal, the higher the market share resulting from a business acquisition, the higher is the likelihood that dominance would be acquired or strengthened. However, conclusions cannot be drawn on market shares alone. As outlined above, the effect of section 3(9) of the Commerce Act is that market share is but one of a number of factors to be taken into account in reaching a view on dominance. The relative weight of these factors must be assessed in each market, which is being examined, but the significance of market share could be outweighed by the other elements, especially the nature of entry conditions.

60 The market for "men's underwear" includes a variety of products: briefs, boxer shorts, singlets, vests and tee shirts. The Commission obtained turnover figures from the parties to the proposal, as well as several major suppliers and competing brands. In its application, Pacific Dunlop estimated that the merged entity would have a market share of [ ], with Sara Lee having [ ] and Davenports having [ ].

61 The figures obtained by the Commission are shown in the Table below.

Table 1 Estimated Market Shares in Men's Underwear Market

Supplier	**Sales Revenue (NZ$000)**	**Estimated Market Share (%)**
Pacific Dunlop	[ ]	[ ]
LWR	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
Sara Lee	[ ]	[ ]
Davenport	[ ]	[ ]
Bendon	[ ]	[ ]
Other	[ ]	[ ]

Constraint from Existing Competition

62 The merged entity would be the largest competitor in this market in terms of market share. The next two largest competitors would be Sara Lee and Davenports with [ ] and [ ] respectively. Sara Lee is a global corporation with business interests in a wide range of product and geographic markets. Sara Lee supplies the New Zealand market with the *Hanes* brand of men's underwear. This is a global brand and has had a presence in the New Zealand market for a number of years where it was manufactured and distributed under license. In November 1999 the *Hanes* brand was taken back "in house" and it is now distributed by Sara Lee Apparel (NZ) Limited.

63 Sara Lee operates a nationwide distribution system predominantly through Farmers Deka stores, other department stores and specialty retail stores. Sara Lee is a supplier of branded product and as such their marketing intensity (marketing expenditure as a percentage of sales) is [ ]. The *Hanes* brand is targeted at the volume part of the market, which is the low to mid part of the market. Sara Lee imports [ ] of their underwear, whilst the remaining [ ] is manufactured locally under contract.

64 Davenport is an Australian company that has been supplying the New Zealand market through its wholly owned subsidiary, Davenport Industries NZ Pty Limited, for the past 6 years. Davenport supplies the market with the *Davenport*, *Calvin Klein* and other licensed brands.

65 The Davenport brands are distributed nationally through department stores and specialty retail stores. Davenport has a marketing intensity of [ ] of sales. The Davenport brand is targeted at the volume part of the market, whilst the Calvin Klein brand is targeted at the upper price points of the market. All of the Davenport range of underwear is imported into New Zealand and most of it is manufactured in Asia.

66 These competitors are competing on the basis of product differentiation. They are investing in their brands, differentiating them from other brands. There is an element of brand loyalty in the purchase of underwear; however the consumer market is price sensitive and the price of the product drives volume. The consumer market will not stay loyal to a brand if there is a significant increase in its price.

67 These competitors are supplying branded product, which have been in the market for some time. They are large organisations with the necessary infrastructure for importing and the capacity to expand supply if the merged entity attempted to exercise market power. They would provide considerable constraint to the pricing and output behaviour of the merged entity.

68 An important recent competitive feature of this market has been the behaviour of the large purchasers, The Warehouse and Farmers Deka. These two retail chains have introduced "house brands" into the retail market, targeting the opening price point of the market. They have been supplied product by LWR under contract manufacture terms, or have backwardly integrated and imported product themselves, branding their product with their house brands. The "house brands" of Farmers Deka are "More", "Chisel", and "Items", whilst the "house brand" of The Warehouse is "Class". These brands are targeted at the volume part of the market.

69 This behaviour by these large purchasers has seen the "price gap" between the branded products and the "house brands" reduce, as the prices for branded product had to decline to ensure their volume of sales was maintained. This is a good example of the competitive nature of the market and the constraint offered by existing competition. Since the deregulation of the New Zealand markets, which allowed the introduction of imports, the price of men's underwear has halved.

Constraint from Potential Competition

70 A business acquisition is unlikely to result in the acquisition or strengthening of dominance if there is a credible threat of market entry. Potential competition can act as a constraint on market power, and so an examination of the nature and extent of this constraint is part of the Commission's assessment of competition.

71 Entry conditions, including the nature and height of any entry barriers, must be considered before the threat of new entry, which might constrain the conduct of a merged entity, can be evaluated.

72 A feature of the clothing manufacturing industry is that much production has moved from the western countries to developing countries in Latin America, SouthEast Asia and Eastern Europe. This shift has been driven by cheaper labour rates in these developing countries, which provide them with a sharp advantage in this repetitive form of production.[10] In 1997, China was the top textile producing country with over 20% of the total production. In 1975, China had just over 10% of total production.[11]

73 Labour rates in China are about $0.5 per hour, whilst the rates for the same task in New Zealand are about $9 per hour. The average labour content in a pair of men's underwear is about 4 minutes and this translates into a significant cost advantage in the production process.

74 This trend is evident in New Zealand with a large proportion of clothing manufacture now being performed offshore. The main advantage to manufacturing in New Zealand is the shorter lead times and flexibility. As a result of this trend to offshore production, some of the key competencies required to successfully enter and compete in the market are the skills in sourcing and marketing of underwear.

Economies of Scale

75 Entry into this market would require relatively high sales and marketing expenditure. An important competitive element in the market is product differentiation, the marketing intensity of competitors ranges from [ ] of sales. A competitor with a high market share would enjoy lower unit costs because of the relatively fixed nature of these costs. This would provide an advantage to large scale suppliers however it is not considered to be high barrier to entering this market.

Access to Distribution Channels

76 The distribution channels used by the suppliers of men's underwear include Department Stores and Specialty Retail Stores. The Farmers Deka department stores are nationwide and are targeted at the middle part of the different product markets they are part of. This represents a very large market and as such Farmers Deka are a very important distribution channel to the suppliers to the market. Suppliers need to have their product on retailer's shelf space to maintain a customer base.

77 The Warehouse is another large nationwide department store, which is focused on providing the lowest prices for its customers. This strategy results in low prices for consumers with most products being at "opening price points" (lowest product price in the market). [ ].

78 Access to the Farmers Deka department stores is important for suppliers of brands targeting the middle part of the market, which represents a large proportion of the retail market. A potential supplier of underwear to Farmers Deka would have to adequate financial resources with a good line of credit. They would have to have a good quality, well packaged, well priced product and guaranteed delivery. The potential entrant

[10] "Manufacturing: The World as a Single Machine", The Economist June 20 1998
[11] Ibid

would have to have a trading reputation. Farmers Deka stated that if a potential supplier had those characteristics they would consider purchasing the product.

79 Although access to these important distribution channels require some organisational competencies and trading experience they are not considered to be onerous and do not impose high barriers to entering the market.

Product Reputation and Promotion

80 Product differentiation occurs when consumers perceive that a product differs from its competition on any physical or nonphysical characteristic, including price.[12] Such differentiation may in certain circumstances present a barrier to entry.[13] Established products in a market may enjoy consumer acceptance and preference because of consumer satisfaction or repeated advertising over time. Many buyers prefer the products of known or tried firms over those of new firms of which less is known. This is especially so when quality is neither apparent or cheaply sampled. An entrant may have to charge less or advertise more than incumbents.[14] A newcomer would have to entice customers away from established firms with more than just satisfactory prices.[15]

81 On the facts of the present case there are a number of established brands in the market, and evidence from market participants suggests that there is a degree of brand loyalty. However the market is price sensitive and the recent introduction of "house brands" into the market by the major retailers who differentiated their products on price, resulted in switching occurring and these "house brands" gaining market share.

82 In the present case it appears that the cost of establishing brand loyalty and reputation can be regarded as a moderately low barrier to entry. An entrant with an established overseas brand could enter and market the brand in New Zealand. Generally consumer preferences are homogeneous, especially in western countries, and an investment in selling and marketing the brand should result in the entrant gaining market share. The introduction of "house brands" which are differentiated on price, has also resulted in brand switching in this market.

The Countervailing Power of Buyers

83 A firm may be constrained by any countervailing power possessed by its customers. Buyer power is likely to be high when there is a concentration of buyers and the volume purchases of the buyers are high.[16]

84 On the facts of this case, Farmers Deka have a high degree of purchasing power. They are a large nationwide distributor targeting the very large middle part of the market. They are differentiated from The Warehouse in that they are not a large price discounter. They are a very important distribution channel for suppliers of brands to the volume part of the market.

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[12] D F Greer, *Industrial Organisation and Public Policy* (3rd ed, MacMillan Publishing Company, New York, 1992)
[13] Ibid at 245
[14] P E Areeda, H Hovenkamp, J L Solow, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (Vol IIA, Little, Brown and Company, 1995).
[15] Op cit note 12, at 245
[16] G Johnson, K Scholes, *Exploring Corporate Strategy* (4th ed, Prentice Hall, Europe, 1997) 111

85 If the merged entity attempted to exercise market power by increasing prices by a significant and non transitory amount, or by offering less in terms of service, this large and important purchaser could obtain increased supply from existing suppliers or further expand their range of house brands.

Conclusion on the National Market for the Manufacture and Supply of Men's Underwear

86 The merged entity will have a market share of [ ]. However market share alone is not determinative of dominance. The other factors to which weight has been given include the expansion possibilities for other existing competitors; Davenport, Sara Lee and also Bendon who are currently niche competitors at the high price point end of the market. Weight has also been given to the low barriers to entering this market, and the constraints offered by the major purchasers in this market, Farmers Deka and The Warehouse.

87 On the basis of the matters discussed above, the Commission concludes that Pacific Dunlop is not currently dominant in the market for the manufacture and supply of men's underwear, and would not be likely to acquire a dominant position in this market as a result of the proposed acquisition.

The Market for Thermal Underwear

Market Concentration

88 Thermal underwear is specially designed so as to have exceptional heat-retaining properties. The most common forms of thermal underwear are manufactured from polypropylene and wool products. The Commission obtained turnover figures from the parties to the proposal, as well as several major suppliers and competing brands. These market share figures are outline below in Table 2.

Table 2
Estimated Market Shares of the Thermal Underwear Market

Suppliers	**Revenue Turnover (NZ$000)**	**Estimated Market Share (%)**
Pacific Dunlop	[ ]	[ ]
LWR	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
Weft	[ ]	[ ]
Finespun Wools	[ ]	[ ]
Survival Apparel	[ ]	[ ]
Macpac	[ ]	[ ]
Sara Lee	[ ]	[ ]
Other	[ ]	[ ]

89 The merged entity would have a market share of [ ] of which about [ ] would be product supplied by contract manufacture. The next two largest competitors would have market shares of [ ]. These levels of market share would be outside the

Commission's 'safe harbour' guidelines. This indicator does raise potential dominance concerns, and an analysis of these markets will be conducted below.

Constraint from Existing Competition

90 The merged entity would be the largest competitor in the market in terms of market share. The acquisition will result in aggregation of about [ ]. The merged entity would supply the *Thermotech, Liberty, Vogue* , and *Superfit* brands to the market. They would also manufacture "house brands" on a contractual basis for a major retailer.

91 The next two largest competitors would be [ ] respectively. [ ] would be the third largest competitor with a market share of share of [ ].

92 Finespun Wools Limited is a manufacturer and supplier of predominantly wool based thermal underwear. It operates a nationwide distribution network, predominantly through department stores and tourist stores. Its main business is the manufacture of garments on a contract basis for large retailers who sell the products as house brands.

93 Weft Industries Limited is a New Zealand manufacturer and distributor of the *Thermadry* and *Polarstat* brands of thermal underwear. It has been producing thermal underwear for about 18 years and operates nationwide distribution through specialty retail stores. They have a capacity utilisation rate of [ ].

94 Survival Apparel Limited is a New Zealand manufacturer and distributor of the *Everwarm* brand of thermal underwear, which is a polypropylene based product. It has been in the market for about 15 years and operates a nationwide distribution network, through department stores and specialty retail stores. Its marketing intensity is relatively high, and they currently export about [ ] of their production.

95 There are also a number of smaller suppliers to the market who supply brands such as *Hanes, Icebreaker, Macpac* and *Bivouac*.

96 Competition at the retail level is placing pressure on wholesale margins in this market. There is excess capacity in the knitting of spun yarn in New Zealand, and competitors are constrained in their ability to increase wholesale prices by existing competition.

97 Like the underwear market these competitors are competing on the basis of product differentiation. They are targeting the volume part of the market. These competitors have supplied the market with branded product for sometime and would have a certain degree of brand loyalty. If the merged entity attempted to exercise market power by increasing its product prices or by offering less in terms of service, the Commission believes that these existing competitors could offer considerable constraint by increasing their supply to the market. They are established suppliers with the necessary capacity and infrastructure to expand supply to the domestic market.

98 The large retail chains which are large purchasers of thermal underwear could also constrain an attempt by the merged entity to exercise market power, by negotiating with other contract manufacturers either domestically or overseas to increase supply through the introduction of "house brands".

Constraint from Potential Competition

99 The competencies required to successfully enter this market include the ability to manufacture or source overseas a supply of knitted garments. The ability to market the

manufactured branded product and the ability to access distribution channels are needed also. The resources required for manufacture include specialised plant and equipment and skilled labour for the manufacturing and marketing processes.

The Capital Cost of Entry

100 Entry into the manufacturing side of the market would require an investment in plant and equipment used in the 'knitting' of spun yarn into garments. Some of these processes could be "outsourced"; however a capital investment of between [ ] would be required to ensure an efficient scale of production.

Access to Needed Inputs

101 Polypropylene fibre and wool are the more commonly used raw materials in the manufacture of thermal underwear. There is one global producer of polypropylene and three suppliers of spun yarn. Only 2% of polypropylene production is used in textile production. There are no barriers to accessing supply of spun yarn or having product manufactured. Product could be manufactured on a contract basis either domestically or overseas or it could be manufactured through an investment in plant and equipment. There are no barriers to obtaining the necessary plant and equipment. The 'knitting machines' used in the production process can be used for a number of fibres.

102 Other entry and expansion conditions include economies of scale in marketing, access to distribution channels, and product reputation and promotion. These entry conditions for the thermal underwear market are similar to those of the men's underwear market and have been discussed above in para 70 to 82.

The Countervailing Power of Buyers

103 Distribution is less concentrated in this market with product being distributed through department stores and specialty sporting and men's and women's retailing stores. However major retail chains like Rebel Sports, Stirling Sports and Farmers Deka are still in a position to exercise countervailing power if the merged entity attempted to exercise market power.

104 These major retail chains could seek increased supply from existing competitors or have product made under contract either domestically or overseas and market the product under their own house brands.

Conclusion on the Market for the Manufacture and Supply of Thermal Underwear

105 The merged entity would have a market share of [ ] of which about [ ] would be contract manufactured. These figures would be outside the Commission's "safe harbour" guidelines. The next largest competitors would be [ ] with market shares of [ ] and [ ] with a market share of [ ].

106 If the merged entity attempted to exercise market power, purchasers of the product could obtain increased supply from existing competitors. The barriers to entering the market are not onerous and the threat of entry would also constrain the merged entity. The countervailing power of buyers offers further constraint.

107 The Commission's examination of these factors has led it to conclude that Pacific Dunlop is not currently dominant in the market for the manufacture and supply of thermal underwear, and would not be likely to acquire a dominant position in this market as a result of the proposed acquisition.

The Market for the Manufacture and Supply of Adult Socks

Market Concentration

108 The Commission has obtained sales revenue figures from major market participant for the purpose of identifying the market shares of these participants. The merged entity would be a large manufacturer/supplier to this market. It would have a market share of about [ ] of which about [ ] would be contract manufactured. The next largest competitors would have market shares of [ ] and [ ] respectively. These market share figures are outlined in Table 3 below.

Table 3
Estimated Market Shares for the
Manufacture and Supply of Adult Socks

Suppliers	Sales Revenue (NZ$000)	Estimated Market Share (%)
Pacific Dunlop	[ ]	[ ]
LWR	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
NZ Sock Company	[ ]	[ ]
Southern Alpsocks	[ ]	[ ]
Merle-Tex	[ ]	[ ]
Performance Hosiery	[ ]	[ ]
Comfort Socks	[ ]	[ ]
Columbine	[ ]	[ ]
Other	[ ]	[ ]

109 The merged entity would have a market share of [ ] which would be outside the Commission's 'safe harbour' guidelines. This indicator does raise potential dominance concerns, and an analysis of these markets will be conducted below.

Constraint from Existing Competition

110 The major existing competitors of the merged entity in this market would be The New Zealand Sock Company Limited ("NZ Sock"), and Southern Alpsocks Limited ("Alpsocks"). Both of these suppliers are domestic manufacturers supplying branded product and product manufactured under contract.

111 NZ Sock has a manufacturing facility in Ashburton and supplies the market with a broad range of product with an emphasis on the 'outdoor' product. Most of their supply is of their own branded product, which includes the *The New Zealand Sock Company* brand. They distribute a large proportion of their product through Farmers

Deka on a nationwide basis. NZ Sock are competing on the basis of product differentiation, producing a quality New Zealand made product.

112 Alpsocks are a Timaru based manufacturer of socks. They supply the market with their own branded product including *Nato, Thermal, Outsider* and *Extreme*. They also supply socks manufactured under contract. They have national distribution for their products through The Warehouse chain of stores. Alpsocks main product is the outdoor activity sock, it does not produce many dress socks. It is competing on the basis of product differentiation through a quality well priced product. Its capacity utilisation is about [ ].

113 There are also a number of smaller competitors supplying the market. These include Columbine Industries Limited, Merle Tex International, Performance Hosiery Limited, and Comfort Socks. These manufacturers supply their own branded product and contract manufacture for purchasers supplying the retail market with “house brands”.

114 These competitors have established competencies in the manufacture and supply of socks to the New Zealand market. They have excess capacity, which could be used to expand supply if the merged entity attempted to exercise market power. They have the advantage of being small, close to the market, with the flexibility to react quickly.

115 The merged entity would be a large supplier of socks manufactured overseas and would have some cost advantages due to the lower overseas production costs. It would also have increased purchasing power with suppliers of raw materials. However existing competitors have the opportunity to supply product manufactured overseas and could do so if the merged entity attempted to exercise market power.

Constraint from Potential Competition

116 The competencies required to enter the market include experience in the manufacture or overseas sourcing of socks, the ability to market the product and access distribution. The resources required include sewing and knitting machines, access to raw material and skilled labour to operate and service the machinery.

The Capital Cost of Entry

117 To enter the market on a reasonable scale would require an investment in plant and equipment of between [ ]. Technology is not changing rapidly and the economic life of this machinery would be long. There is a market for second hand machinery, so the sunk cost component of the investment would be relatively low.

118 Other entry and expansion conditions include economies of scale in marketing, access to distribution channels, and product reputation and promotion. These entry conditions for the adult sock market are similar to those of the men’s underwear market and have been discussed above in para 70 to 82.

119 The barriers to entering the market for the manufacture and supply of adult socks are not onerous. An entrant could enter the market if the opportunity arose, provided it had sufficient capital for investment in plant and equipment, or the ability to source quality product manufactured overseas. It would also require a supply of skilled labour and access to a distribution channel. However if the merged entity were attempting to exercise market power there would be few difficulties in accessing distribution channels.

120 The Commission believes that the threat of entry into this market would constrain the merged entity.

The Countervailing Power of Buyers

121 Farmers Deka and The Warehouse are large purchasers and their concentration in the acquisition side of the market results in a large degree of purchasing power. They are both nationwide distributors to the very large low and middle parts of the market and are important distribution channels for suppliers of brands to this part of the market.

122 If the merged entity attempted to exercise market power by increasing prices or by offering less in terms of service, these two purchasers could constrain the merged entity by obtaining increased supply from existing competitors or by backwardly integrating and sourcing overseas supply themselves of branded products or house brands.

Conclusion on the National Market for the Manufacture and Supply of Adult Socks

123 The merged entity would have a market share [ ] which would be outside the Commission's 'safe harbour' guidelines. An analysis of the other relevant factors has concluded that in the medium to long term existing competitors could expand supply and constrain the merged entity if it attempted to exercise market power.

124 Barriers to entering this market are not onerous, and if it was profitable to do so, a new entrant could enter the market and constrain the merged entity. The threat of such entry is a constraining factor. There is a high degree of purchasing power, which would further constrain the merged entity.

125 On the basis of the matters discussed above, the Commission concludes that Pacific Dunlop is not currently dominant in the market for the manufacture and supply of adult socks, and would not be likely to acquire a dominant position in this market as a result of the proposed acquisition.

The Market for the Manufacture and Supply of Women's Underwear

Market Concentration

126 The Commission obtained sales revenue figures from major participants in this market for the purpose of precisely identifying market shares. The analysis of this market has concluded that the merged entity would not have the largest market share. These market shares are outlined in Table 4 below.

Table 4
Estimated Market Shares for the Market for the Manufacture and Supply of Women's Underwear.

Suppliers	Sales Revenue (NZ$000)	Estimated Market Shares (%)
Pacific Dunlop	[ ]	[ ]
LWR	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
Bendon	[ ]	[ ]
Sara Lee	[ ]	[ ]
Triumph	[ ]	[ ]
Davenport	[ ]	[ ]

127 The merged entity would be within the Commission's 'safe harbours' with a market share of [ ]. Bendon would be the largest competitor with a market share of [ ]. A market share within the Commission's 'safe harbour' guidelines does not indicate dominance, however a competition analysis will be conducted to ensure that dominance will not be acquired.

Constraint from Existing Competition

128 Bendon is the largest supplier to this market. It has an established brand in the market, which is supported by a relatively large investment in the brand. The brand is distributed nationally through department stores and specialty stores. Bendon has a broad product range and its brands are represented in all parts of the market with emphasis on the middle to upper part of the market.

129 Sara Lee would also be a large competitor of the merged entity. It is a large global corporation with good sourcing competencies. Sara Lee distributes nationally and has several brands targeted at the middle to upper part of the volume market. It is competing on the basis of product differentiation and has a relatively high marketing intensity.

130 Both of these competitors offer significant constraint to the merged entity, and any attempt to exercise market power would result in loss of business for the merged entity. There is an element of brand loyalty in the purchase of underwear; however the consumer market is price sensitive and the price of the product drives volume. Evidence from the market suggests that consumers will not stay loyal to a brand if there is a significant increase in its price.

Constraint from Potential Competition

131 The entry conditions to this market are very similar to that of the men's underwear market. However, some of the manufacturing processes are more complex in some product manufacture. These entry conditions have been analysed above at para 70 to 82.

132 Barriers to entering this market are not onerous and the threat of such entry would act as a significant constraint to the merged entity.

Countervailing Power of Buyers

133 The purchasing power of buyers is similar to that of purchasers of men's underwear and has been analysed above at para 83 to 85.

Conclusion on the National Market for the Manufacture and Supply of Women's Underwear

134 The merged entity would have a market share of about [ ], and would not be the largest supplier to the market. It would be significantly constrained by existing competitors and the threat of new entry.

135 On the basis of the matters discussed above, the Commission concludes that Pacific Dunlop is not currently dominant in the market for the manufacture and supply of women's underwear, and would not be likely to acquire a dominant position in this market as a result of the proposed acquisition.

The Market for the Manufacture and Supply of Children's Socks

Market Concentration

136 The Commission obtained sales revenue figures from major participants in this market for the purpose of precisely identifying market shares. The analysis of this market has concluded that the merged entity would have the largest market share with a figure of [ ] of which about [ ] is contract manufactured. The next largest competitors would be SM Designs Limited with [ ] and Columbine with [ ]. The market share figures are outlined below in Table 5.

Table 5 Market Shares for the Market for the Manufacture and Supply of Children's Socks

Suppliers	Sales Revenue (NZ$000)	Estimated Market Share (%)
Pacific Dunlop	[ ]	[ ]
LWR	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
SM Designs	[ ]	[ ]
Columbine	[ ]	[ ]
Merle Tex	[ ]	[ ]
Comfort Socks	[ ]	[ ]
Performance Hosiery	[ ]	[ ]

137 The merged entity would have a market share of [ ], whilst the next two largest competitors have market shares of [ ] and [ ] respectively. These market shares are within the Commission's safe harbour guidelines. A market share within these guidelines does not usually indicate dominance, however a competition analysis will be conducted to ensure that dominance will not be acquired.

Constraint from Existing Competition

138 The major existing competitors of the merged entity would be SM Designs Limited, Columbine Hosiery, NZ Sock Company, Southern Alpsocks, Merle Tex, and Performance Hosiery. SM Designs and Columbine Hosiery have market shares of [ ] and [ ] respectively. The other suppliers are currently not supplying this market but could do so quickly by switching production from adult socks to children's socks. This switching in production would not require significant investment in sunk costs. An analysis of these existing competitors was conducted above at paragraphs 110 to 115.

Constraint from Potential Competition

139 The entry conditions for this market are the same for the adult sock market. This market was analysed at paragraphs 116 to 120.

The Countervailing Power of Buyers

140 This market has similar purchasing power characteristics to the adult sock market. These characteristics have been discussed at paragraphs 121 to 122 above.

Conclusion on the National Market for the Manufacture and Supply of Children's Socks

141 The merged entity would have the largest market share with a figure of [ ] of which [ ] is contract manufactured. The next largest competitors would have market shares of [ ] and [ ] respectively. An analysis of the relevant factors has concluded that supply could be increased by existing competitors if the merged entity attempted to exercise market power. Barriers to entering the market are not onerous, and if it was profitable to do so, a new entrant could enter the market and constrain the merged entity. There is also a high degree of purchasing power, which could constrain the merged entity.

142 On the basis of the matters discussed above, the Commission concludes that Pacific Dunlop is not currently dominant in the market for the manufacture and supply of children's socks, and would not be likely to acquire a dominant position in this market as a result of the proposed acquisition.

OVERALL CONCLUSION

143 Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission is satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the following markets:

- the manufacture and supply of men's underwear;
- the manufacture and supply of thermal underwear;
- the manufacture and supply of adult socks;
- the manufacture and supply women's underwear;
- the manufacture and supply of children's socks;
- the manufacture and supply of pantyhose; and
- the manufacture and supply of bras.

DETERMINATION ON NOTICE OF CLEARANCE

144 Accordingly, pursuant to section 66(3) of the Act, the Commission determines to give clearance for the proposed acquisition by Pacific Dunlop Holdings (NZ) Limited of certain assets and businesses of LWR Hosiery and Underwear Limited and R & WH Symington Limited.

Dated this 29th day of February 2000

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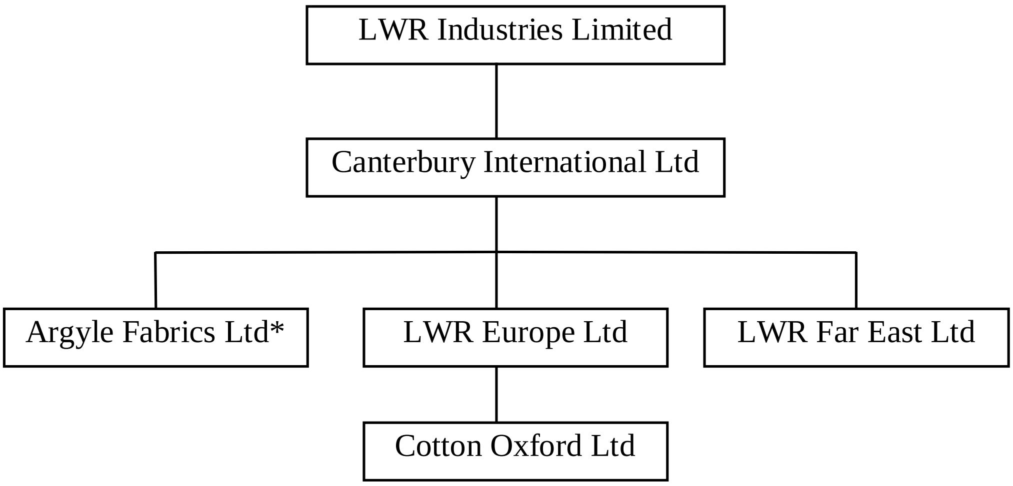
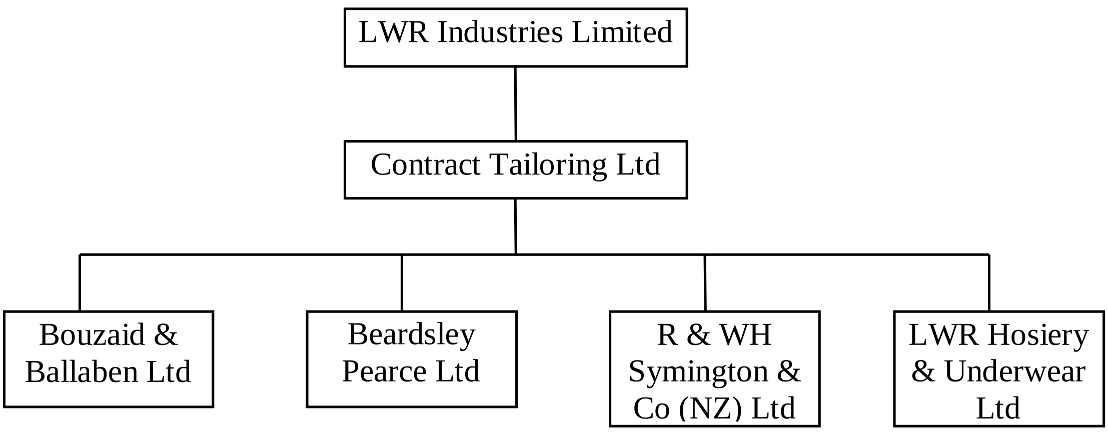
M J Belgrave
Chair

APPENDIX 1

Corporate Structure of LWR Group
(Interconnection/Association)

Subsidiary Groups





* Name changed to LWR Manufacturing Ltd in January 1999