



COMMERCE COMMISSION

Decision No. 502

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

WESFARMERS INDUSTRIAL & SAFETY NEW ZEALAND LIMITED

and

PAYKEL LIMITED

The Commission: Paula Rebstock
Donal Curtin
Peter JM Taylor

Summary of Application: The acquisition by Wesfarmers Industrial & Safety NZ Limited (“WISNZ”) to purchase all of the assets of Paykel Limited (“Paykel”).

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

Date of Determination: 26 June 2003

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CONTENTS

CONTENTS	1
EXECUTIVE SUMMARY	3
OVERALL CONCLUSION	4
THE PROPOSAL	5
THE PROCEDURES	5
THE PARTIES	5
WESFARMERS INDUSTRIAL & SAFETY NZ LIMITED (“WISNZ”)	5
PAYKEL LIMITED (“PAYKEL”)	6
THE TIRI GROUP (“TIRI”).....	6
OTHER RELEVANT PARTIES	6
BGH GROUP (“BGH”).....	6
TRADE TOOLS	6
TRADE ZONE GROUP (“TRADE ZONE”).....	6
WILSON BROTHERS GROUP	7
BOC LIMITED (“BOC”).....	7
PREVIOUS INVESTIGATIONS	7
INDUSTRY BACKGROUND	7
STRUCTURE.....	7
<i>Competitors</i>	8
<i>Customers</i>	9
CONDUCT.....	9
MARKET DEFINITION	10
RELEVANT MARKET	10
<i>Product Market</i>	10
<i>Functional Market</i>	13
<i>Geographic Market</i>	13
CONCLUSION ON THE RELEVANT MARKET	15
COMPETITION ANALYSIS	15
COUNTERFACTUAL	15
MARKET CONCENTRATION	16
EXISTING COMPETITION.....	18
<i>Conclusion on Existing Competition</i>	20
<i>Barriers to Entry</i>	20
<i>The “LET” Test</i>	21
<i>Likelihood of Entry</i>	21
<i>Extent of Entry</i>	21
<i>Timeliness of Entry</i>	22
<i>Conclusion on Constraint from Potential Competition</i>	22
OTHER COMPETITION FACTORS	22
<i>Constraint from Buyers</i>	22
<i>Constraint from suppliers</i>	23
OVERALL CONCLUSION	23
DETERMINATION ON NOTICE OF CLEARANCE	24
APPENDIX ONE	25

MARKET SHARES IN THE DISTRIBUTION OF ENGINEERING/INDUSTRIAL SUPPLIES IN EACH OF THE 12 REGIONS 25

TABLE 1: MARKET SHARE FOR NORTHLAND.....	25
TABLE 2: MARKET SHARE FOR AUCKLAND.....	25
TABLE 3: MARKET SHARE FOR WAIKATO.....	26
TABLE 4: MARKET SHARE FOR BAY OF PLENTY.....	26
TABLE 5: MARKET SHARE FOR HAWKE’S BAY (INCLUDING GISBORNE).....	27
TABLE 6: MARKET SHARE FOR TARANAKI.....	27
TABLE 7: MARKET SHARE FOR MANAWATU/WANGANUI.....	28
TABLE 8: MARKET SHARE FOR WELLINGTON (INCLUDING WAIRARAPA).....	28
TABLE 9: MARKET SHARE FOR MARLBOROUGH/NELSON.....	29
TABLE 10: MARKET SHARE FOR CANTERBURY.....	29
TABLE 11: MARKET SHARE FOR OTAGO.....	30
TABLE 12: MARKET SHARE FOR SOUTHLAND.....	30

EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") was received on 3 June 2003. The notice sought clearance for an application from Wesfarmers Industrial & Safety New Zealand Limited ("WISNZ") to purchase all of the assets of Paykel Limited ("Paykel").
2. The Tiri Group ("Tiri") will sell the business assets of Paykel Limited, including the Paykel name, to WISNZ. Post acquisition, Paykel Limited will be a separate entity which will continue to be 100% owned by Tiri, despite not having any assets. Tiri will complete all the statutory obligations and then wind the company up.
3. The Applicant sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

Market Definition

4. The Commission concludes that, for the purpose of analysing this application, the relevant market is the distribution of engineering/industrial supplies, in the geographic regions adopted by the Applicant. Analysis has focused on the 12¹ regions in which the aggregation occurs.

Counterfactual

5. There is no indication that Paykel will cease trading if the acquisition does not proceed. The Commission considers the appropriate counterfactual is the status quo.

Competition Analysis

Existing Competition

6. In 11 out of the 12 geographic regions, the merged entity has a market share of [] in the distribution of engineering/industrial supplies. In Southland, the merged entity has market share of [] although the increment is [].
7. In each of the 12 regions, the merged entity would be constrained by national competitors, namely, BGH Group, Trade Tools and Trade Zone and a plethora of smaller specialist competitors. The merged entity would be constrained by these companies who distribute a wide range of engineering/industrial supplies, as well as, the specialist companies who specialise in one product line.

¹ Northland, Auckland, Waikato, Bay of Plenty, Hawke's Bay, Taranaki, Manawatu (and Wanganui), Wellington (including Wairarapa), Marlborough (and Nelson), Canterbury, Otago and Southland.

Potential Competition

8. The Commission concludes that barriers to entry in the distribution of engineering/industrial supplies are low. A new entrant in the regional distribution of engineering/industrial products would need access to facilities near its customers, access to engineering/industrial supplies, sales representatives and technical knowledge on the products distributed. These resources could be acquired quickly and easily. The likelihood, extent and timeliness of entry in the distribution of engineering/industrial supplies are sufficient to act as a constraint on the merged entity.

Overall Conclusion

9. In the market for the distribution of engineering/industrial supplies, in each of the 12 regions in which the aggregation occurs, the Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, as the merged entity would be constrained by existing and potential competition.

THE PROPOSAL

10. A notice pursuant to section 66(1) of the Commerce Act 1986 (“the Act”) was received on, 3 June 2003. The notice sought clearance for an application from Wesfarmers Industrial & Safety NZ Limited (“WISNZ”) to purchase all of the assets of Paykel Limited (“Paykel”).
11. The Tiri Group (“Tiri”) will sell the business assets of Paykel Limited, including the Paykel name, to WISNZ. Post acquisition, Paykel Limited will be a separate entity which will continue to be 100% owned by Tiri, despite not having any assets. Tiri will complete all the statutory obligations and then wind the company up.

THE PROCEDURES

12. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the Applicant. Accordingly, a decision on the application was required by 26 June 2003.
13. The Applicant sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission’s determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
14. The Commission’s determination is based on an investigation conducted by staff.
15. The Commission’s approach is based on principles set out in the Commission’s *Practice Note 4*.²

THE PARTIES

Wesfarmers Industrial & Safety NZ Limited (“WISNZ”)

16. WISNZ is owned by Wesfarmers, one of Australia’s largest public companies with operating revenue of \$7.4 billion in 2001/02 and profits after tax of \$414 million. In New Zealand, Wesfarmers has interests in retailing of home and garden improvement products, building materials, as well as industrial and safety product distribution. It operates under the brands NZ Safety, Protector Safety Supply and Packaging House.
17. Wesfarmers also owns Howard Smith Limited, Wesfarmers Industrial & Safety Holdings NZ Limited (“WISNZH”) and Valley Investments Pty Limited (“Valley Investments”).
18. Valley Investments owns Benchmark Building Supplies Limited (“BBS”) in New Zealand. BBS owns J. Blackwood & Son (N.Z.) Limited (“Blackwoods”), Morris Black & Matheson (1994) Limited (“MBM”), Hardwarehouse Limited (“Hardwarehouse”) and BBC Hardware (NZ) Limited (“BBCH”). BBCH owns the Bunnings Warehouses.

² Commerce Commission, *Practice note 4: The Commission’s Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

Paykel Limited (“Paykel”)

19. Paykel is an engineering supplies company that is based in New Zealand. It has been operating in New Zealand since the 1920’s.

20. Paykel has three operating divisions. These are:

- Paykel, the largest division, supplying engineering and related products and services;
- Supply Solutions provides engineering and industrial supplies; and
- Machine Tools is a provider of high quality conventional machine tools.

The Tiri Group (“Tiri”)

21. Tiri is an investment company owning various businesses in the industrial and engineering sector.

OTHER RELEVANT PARTIES

BGH Group (“BGH”)

22. BGH Group (“BGH”) is comprised of Bay Engineers Supplies Ltd, General Machinery Company Ltd, Maud Kirk Machinery Ltd and Hose Supplies NZ Ltd. These branches are industrial distribution companies that distribute a range of engineering/industrial supplies. BGH is owned by individuals in Tauranga. It consists of six branches under Bay Engineering Supplies Ltd, five branches under General Machinery, four branches under Hose Supplies and one branch under Maud Kirk Machinery Ltd.

Trade Tools

23. Trade Tools was established in 1955. It is a leading supplier of cutting tools, hand tools and related products to industry. The company stocks around 22,000 items. Trade Tools has seven branches throughout New Zealand, employing 50 people, which includes a team of qualified sales engineers.

Trade Zone Group (“Trade Zone”)

24. Trade Zone is a nationwide cooperative group of independent businesses with 23 outlets. The group is, basically a buying group and undertakes joint marketing activities. Its members consist of:

- Farrand & Mason;
- Bindon Auto Electrical;
- Auckland Engineering Supplies;
- Grossman Twigg Engineering Supplies;

- Hand Tool House;
- Total Trade Supplies;
- Workplace & Engineering Supply;
- Holster Supply;
- Stewart & Cavalier Engineering Supplies;
- Croucher & Croucher;
- McDonald Equipment;
- Techweld, Engineering Supplies;
- Blenheim Engineering Supplies;
- George Henry & Co, CM Engineering;
- Timaru Engineering Supplies;
- Engineering Wholesalers; and
- E Hayes & Sons.

Wilson Brothers Group

25. The Wilson Brothers Group is a leading engineering supplier in the South Island. The company has been active since 1919 and consists of Wilson Brothers Ltd, Wilson Engineering, Butlers Foundry Ltd, Southland Hydraulic Services Ltd & Wilson Bros Diesel and Malcolm Officer Sheetmetal. In total it has seven branches. There are five branches in Invercargill, one in Christchurch and one in Dunedin. The Wilson Brothers Group provides a wide variety of products including bearings, welding, abrasives, industrial plastics and seals.

BOC Limited (“BOC”)

26. BOC is a large provider of gases and related products. It is a world-wide company that has several branches throughout New Zealand. In New Zealand it is active in distributing safety products, welding products, abrasives, gas equipment and trade tools.

PREVIOUS INVESTIGATIONS

27. In June 2001, the Commission cleared the acquisition by Howard Smith Ltd of OPSM Protector Ltd³. The relevant markets considered were the national supply of safety products and the national supply of janitorial, hygiene and medical products.

28. In the national supply of safety products, it was concluded that the merged entity would be constrained by the countervailing power of purchasers, which would reinforce the constraint from existing and potential competitors. In the national supply of janitorial, hygiene and medical products there was a considerable amount of existing competition.

INDUSTRY BACKGROUND

Structure

29. The Applicant states that the market affected by this merger is the market for Maintenance, Repair & Operating Consumables (“MRO”). MRO consists of a wide range

³ Decision No.433

of engineering/industrial supplies that are used to produce a product, in the manufacturing process, or used to provide a service. Examples of such products are hand and power tools, fasteners, abrasives, pumps, valves, safety and cleaning products.

30. Wesfarmers distributes engineering/industrial supplies through its Blackwoods stores and to a very limited extent through its BBS and Bunnings stores⁴. Paykel distributes products through its own Paykel stores. Therefore the proposed acquisition would result in an aggregation between Paykel and Blackwoods.
31. Both Blackwoods and Paykel distribute engineering/industrial supplies to various types of industries like agricultural, forestry, fishing, mining, manufacturing, utilities, construction, transport/logistics and government departments.

Competitors

32. Engineering/industrial supplies are distributed by large distributors and a plethora of smaller, specialist distributors. Blackwoods and Paykel are both large distributors of engineering/industrial supplies. Other large distributors are:
 - Trade Zone;
 - BGH Group;
 - Trade Tools; and
 - Wilson Brothers Group.
33. These larger companies, except for Wilson Brothers Group which is active mainly in the South Island, have a presence in most regions in New Zealand. These firms distribute a broad product range and as such are able to offer a one-stop-shop for industrial consumers. For example, Paykel has a product list that consists of some 300,000 items. Blackwoods has a product list of around 400,000 items. These items will consist of variations of similar products. The proposed acquisition results in an aggregation in only twelve distinct products.
34. In addition to the large distributors of engineering/industrial supplies, there are numerous smaller independent suppliers that provide engineering/industrial supplies. There are also a large number of specialist distributors who offer a greater range of products in any one particular product line servicing the requirements of niche customers. For example, some market participants specialise in the supply of fasteners, and others tools.
35. Specialist companies attract custom via their quality of service and product, as well as, their expertise in their field. Specialist suppliers are likely to have employees with more specific and technical knowledge of the narrower range of products offered and specific market segments. However it appears that smaller operators can expand to carry a broader product range with relative ease.
36. Both small and large companies compete to develop a reputation for stocking high quality products and specific brands (including own brands). Both Blackwoods and Paykel have

⁴ [] of BBS's annual turnover was from distributing engineering/industrial supplies.

house brands. Other brands, for example in power tools are Makita, Hitachi, Bosch and P&N brands.

Customers

37. Customers purchasing engineering/industrial supplies tend to contact suppliers to place orders via telephone, fax, email or personal visits. There are various types of customers and they vary in size.
38. Large customers, purchasing engineering/industrial supplies in large quantities, have national or multi-site requirements and so will generally negotiate national prices and national service standards with a national supplier. However products are supplied on a regional basis. In some rare cases there will be a specialist, unique or other one off transaction that may be arranged via the respective head office.
39. These large customers will have formal contracts with suppliers or they will have informal contracts, namely, preferred supplier agreements.
40. There are a minimal number of formal (legally binding) contracts. These contracts vary in length from 12 months to 6 years. The most common contract would be for 2-3 years with options of additional 12 month periods given the customer's satisfactory review process.
41. These contracts can consist of up to 5,000 items. Some agreements are limited to a specific range of products. A basket of goods is generally selected to form the basis of the contract with pricing fixed for a period of time. These items would generally be high volume products required on a monthly or weekly basis. Items outside the basket of goods would be supplied at a discounted rate from the list price competitive with the general market.
42. Some engineering/industrial supplies are sold to competitors. This occurs when companies have a contract to provide a range of engineering/industrial supplies, which they themselves do not stock. Such products are then purchased from specialist or other competitors. For example, [] purchases fasteners from [] to provide the full package of goods to large customers. However, only a small proportion of sales are between competitors, and these are primarily sales by a specialist to a national competitor.
43. Small customers are trades people, and to a lesser extent, the "do it yourself" ("DIY") customer. These customers, which could be local factory owners, tend to visit stores and make small, ad hoc purchases.

Conduct

44. Customers tend to purchase engineering/industrial supplies from larger suppliers as they can provide a one-stop shop, allowing customers to get volume discounts. The merged entity and most of its competitors have list prices. Blackwoods has discounts for different types of customers. These are:

- [

].

45. Paykel has a similar type of discount structure. [

].

MARKET DEFINITION

46. 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.

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

48. The Commission defines relevant markets in terms of four characteristics or dimensions:

- the goods or services supplied and purchased (the product dimension);
- the level in the production or distribution chain (the functional level);
- the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
- the temporal dimension of the market, if relevant (the timeframe).

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

Relevant Market

Product Market

50. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers’ eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

51. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.⁵ The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the ‘ssnip’ test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.
52. The Applicant submits that the relevant product market is the supply of MRO products. In this merger the Applicant states that there is an aggregation in 12 MRO product lines. These are:
- Hand and power tools;
 - Cutting tools;
 - Transmission;
 - Welding;
 - Materials handling;
 - Pumps;
 - Safety;
 - Valves;
 - Fastenings;
 - Hoses and fittings;
 - Abrasives; and
 - Packaging.
53. The Commission’s investigations found that industry participants commonly referred to the term engineering/industrial supplies rather than MRO products. Further, the 12 product lines were considered to be engineering supplies used for all types of industrial and engineering activities. These products tended to be small, and sometimes low value, items that were frequently used.
54. As can be seen from the list above, one of the 12 product lines, where the aggregation occurs, is safety products. In the Howard Smith/OPSM Protector merger, the supply of safety products was considered to be a separate product market. Market investigations found no reason to believe that this has changed. There are different competitors active in this market and there are separate contracts that are tendered specifically for safety products.
55. Table 1 below shows that there is a minor aggregation in the supply of safety products. Of the 12 product lines, safety products represented [] of Paykel’s sales last year, compared to [] of Blackwood’s sales. This minor aggregation is not considered further.

⁵ In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: “A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive”.

Table 1: Blackwoods and Paykel's Sales for Each the 12 Product Lines

Category	Blackwoods Sales YE 30/6/03	% of total sales for the 12 products	Paykels Sales YE 30/6/03	% of total sales for the 12 products
Hand & power tools	[]	[]	[]	[]
Cutting tools	[]	[]	[]	[]
Transmission	[]	[]	[]	[]
Welding	[]	[]	[]	[]
Materials handling	[]	[]	[]	[]
Pumps	[]	[]	[]	[]
Safety	[]	[]	[]	[]
Valves	[]	[]	[]	[]
Fastenings	[]	[]	[]	[]
Hose & fittings	[]	[]	[]	[]
Abrasives	[]	[]	[]	[]
Packings	[]	[]	[]	[]
Other Industrial	[]	[]	[]	[]
Total	[]	[]	[]	100%

56. For the remaining 11 products where there is an aggregation, on the demand side there is no substitutability between these products, as they all have different specific purposes.
57. However, the distribution process of these 11 products is the same. For instance, there are numerous companies that provide a wide range of engineering/industrial supplies including some, or all of the, 12 product lines listed above.
58. In addition, there are some companies that choose to specialise in one product line, e.g. EDL Fasteners and Hylton Parker Fasteners specialise in distributing fasteners. These companies choose to specialise, as there are advantages in developing the expertise in a particular product line, in order to provide a good quality of service.
59. However these specialist companies would already have stock control systems, sales representatives and warehouse facilities and could expand their product range easily by securing access to engineering/industrial supplies, and if necessary technical knowledge on the products. [] stated that it had purchased products from companies that were extending their product ranges.
60. The merged entity distributes engineering/industrial supplies to large, medium and small sized customers. There is some degree of supply side substitutability between the supply to large customers and the supply to medium and small sized customers. For instance, companies supplying products to medium and small sized customers could switch to supplying large national customers by extending their product range, acquiring the ability to cope with delivery a large volume of products on time and gaining the ability to provide to technical expertise when required.
61. In conclusion, the Commission considers the relevant product market to be engineering/industrial supplies due to the high degree of supply side substitutability between the 11 remaining product lines.

Functional Market

62. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.⁶ Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.
63. The Applicant submits that the functional level of the businesses of Blackwoods and Paykel is the supply of products as opposed to the manufacture, retail sale or use of products.
64. It appears that the Applicant's stores operate as distribution outlets that are open for trade to local consumers. However, customers actually visiting stores would typically make ad-hoc visits. Market investigations found that the level of retail trade was small. For example, [].
65. In conclusion, the Commission considers the predominant functional level to be distribution.

Geographic Market

66. The Commission seeks to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.
67. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

⁶ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, ..., must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

68. Blackwoods and Paykel both distribute engineering/industrial supplies throughout New Zealand. Paykel is a national supplier with 21 stores. Blackwoods has seven stores, five in the North Island and two in the South Island. The location of these branches are:

- Auckland;
- Rotorua;
- Hastings;
- New Plymouth;
- Wellington;
- Christchurch; and
- Dunedin;

69. In each of the seven town/cities listed above there is also a Paykel store.

70. The Applicant has adopted the regional markets specified in the Fletcher Challenge Limited/New Zealand Forest Products Limited. This consisted of 12 regional markets throughout NZ. These are:

- Northland;
- Auckland;
- Waikato;
- Bay of Plenty;
- Hawke's Bay;
- Taranaki;
- Manawatu (and Wanganui);
- Wellington (including Wairarapa);
- Marlborough;
- Canterbury;
- Otago; and
- Southland.

71. The Applicant stated that distributions are made outside the immediate geographical area of the stores, through distributional channels and sales made by travelling sales representatives.

72. Based on market investigations, the 12 regions provided by the Applicant can be considered to be the relevant geographic markets. This is because engineering/industrial supplies are delivered, via courier to customers in the same region. The majority of companies had sales representatives that actively visited customers in the region.

73. For instance, the Wellington branch for Trade Tools has one sales representative and delivers products to the Wairarapa and Masterton. Blackwood's Wellington branch also delivered to these areas as well as Wanganui. EDL Fasteners delivered products to as far as Palmerston North from its Wellington branch. Further, one customer located in Bay of Plenty had products delivered from Blackwood's Auckland branch, and another customer based in Waverly ordered products from a supplier in Hamilton. A small company [] stated it was active in distributing engineering/industrial supplies in the Taranaki region.

74. Market investigations found that national customers were serviced by regional branches, in order to provide a just in time service. For example, [] required its supplier to have regional branches so that suppliers could provide technical advice to their engineers on a timely basis.
75. The Applicant stated that customers visiting stores travelled within a 10-12km radius to visit a supplier. However this is on an ad-hoc basis and as noted above retail trade is low.
76. In conclusion, the relevant geographic markets can be considered to be the regional markets adopted by the Applicant.

Conclusion on the Relevant Market

77. The Commission concludes that, for the purpose of analysing this application, the relevant market is the distribution of engineering/industrial supplies in the geographic regions defined by the Applicant.

COMPETITION ANALYSIS

78. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.⁷

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

Counterfactual

80. The Applicant states that it does not consider Paykel to be a vigorous competitor because []. However, the Applicant has not stated that []. Further it appears, from Paykel's website, that in Spring 2002 Paykel's sales overall grew by more than 10%, it opened a branch in East Tamaki, and moved three branches to better locations.

⁷ See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* (1987) 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* (1990) 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

81. There is no indication that Paykel would cease trading or attempt to find another purchaser if the acquisition did not take place. The relevant counterfactual is therefore considered to be the status quo.

Market Concentration

82. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.⁸

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

84. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms’ market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or
- where the three-firm concentration ratio (with individual firms’ market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

85. The Applicant submitted market shares for 12 regions. Table 2 below summarises the merged entity’s market shares in each of the regions. Detailed market shares for each region can be found in Appendix 1.

⁸ See the Commission’s Practice Note 4 for further explanation of the Commission’s approach to market share.

Table 2: Merged Entity’s Market Shares in Each of the 12 Regions in the Distribution of Engineering/Industrial Supplies

Region	Paykel	Blackwoods	Post-Acquisition Market Share
Northland	[]	[]	[]
Auckland	[]	[]	[]
Waikato	[]	[]	[]
Bay of Plenty	[]	[]	[]
Hawke’s Bay (including Gisborne)	[]	[]	[]
Taranaki	[]	[]	[]
Manawatu and Wanganui	[]	[]	[]
Wellington (including Wairarapa)	[]	[]	[]
Marlborough and Nelson	[]	[]	[]
Canterbury	[]	[]	[]
Otago	[]	[]	[]
Southland	[]	[]	[]

86. In 11 out of the 12 geographic regions, the merged entity has a market share of [] in the distribution of engineering/industrial supplies. In Southland, the merged entity has market share of [] although the increment is [].
87. Table 3 shows that in each of the 12 regions, both BOC and Trade Zone are present and BGH and Trade Tools are present in most of these areas.

Table 3: Locations of Branches of National and Specialist chains

	BOC	BGH	Trade Tools	Trade Zone	Paykel	Blackwoods
Northland	√	√		√√	√	
Auckland	√√√√√	√√	√	√√	√√√√√√	√
Waikato	√	√	√	√√√√	√	
B/Plenty	√√	√√√√		√√√	√√√	√
H/Bay E/Coast	√√	√	√		√√	√
Taranaki	√	√		√√	√	√
Manawatu/Wang	√	√√	√	√√	√	
Wellington	√	√	√	√	√	√
Nelsn/Marlbg	√√			√	√	
CntbryW/Coast	√√√	√	√	√√√	√√	√
Otago	√			√√	√	√
Southland	√			√	√	

√=branch

88. Also, in each of the 12 regions, the “Others” category represents a large proportion of the market. The Applicant states that the “Others” category consisted of other independent suppliers and retail outlets such as large chains such as Mitre 10, PlaceMakers, and The

Warehouse. Market investigations have found that there are numerous independent suppliers in each of the 12 regions. However, retail outlets are not considered to be credible distributors of engineering/industrial supplies.

89. The Commission agrees with the Applicant that direct imports are generally not a viable form of competition for local distribution of engineering/industrial supplies. The time delay and cost of transportation would be prohibitive and could not be considered as a viable substitute to supply from domestic suppliers.
90. Post merger, the three firm concentration ratio in these 12 regions ranges from []-[]. These market shares are well within the Commission's safe harbours. However market shares are insufficient in themselves to establish whether competition in a market has been lessened. Additional factors must also be considered before a conclusion is reached. These factors are:
- existing competition;
 - potential competition; and
 - other competition factors such as countervailing power.
91. These factors are considered in subsequent sections and the conclusions drawn are the same for each of the 12 regions.

Existing Competition

92. In the distribution of engineering/industrial supplies, market investigations found that companies competed on price, quality of service, technical expertise and product range.
93. In each of the 12 regions, the merged entity would be constrained by numerous competitors. It would face some competition from national competitors, which provide a wide range of products, namely, BGH Group, Trade Zone and Trade Tools as well as from regional competitors who also distribute a variety of engineering/industrial supplies. The merged entity would also be constrained by specialist competitors active in specific regions.
94. Companies that provide a wide range of engineering/industrial supplies or specific products, compete with Blackwoods and Paykel for national customer contracts. Some examples of such competition are provided below.
95. Paykel currently has [] formal contracts. These are with: []].
96. Blackwoods has [] formal contracts and these are outlined in the table below.

97. []

]

98. [

].

99. [

].

100. [], a medium sized customer, stated that there was plenty of competition in North Island. It currently purchased most products from []. Other suppliers that could service its needs were [].

101. The Commission learnt that the [

].

102. [], which has a branch in Auckland and Dunedin, said that it had tendered for national contracts, and that [] were not very strong in the South Island.

103. However, not all large customers purchase engineering/industrial supplies by means of sole supply contracts. Some large customers purchased from several suppliers including specialists. For example, one industry participant purchased from both Blackwoods and Paykel in a formal contract but also purchased from Serco, as well as 1100 other suppliers. Further, EDL Fasteners, which is a national specialist chain, has national contracts to supply fasteners to []. PPS Industries supplies [] with abrasives.

104. Market investigations found that medium and small sized customers purchased engineering/industrial supplies from specialist stores in the regions, as they offered a better quality of services, as well as from the one-stop stores. [

].

105. Overall, large customers were content with the choice of one-stop shop providers and would and do purchase from specialist suppliers of engineering/industrial products. Small customers like [] were equally content with the choice of suppliers.

Conclusion on Existing Competition

106. The Commission considers that the significant level of existing competition in each of the 12 regions does not substantially change post acquisition due to the constraints from other suppliers.

Potential Competition

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

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

109. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry.

Barriers to Entry

110. A new entrant in the regional distribution of engineering/industrial supplies would need access to facilities near its customers, access to engineering/industrial supplies, sales representatives and technical knowledge on products distributed.

111. One industry participant estimated that it would cost around \$300,000 to set up a new branch.

112. Access to engineering/industrial supplies is not considered difficult. Market investigations found that some engineering/industrial supplies are sourced domestically or from overseas. For example, Trade Tools imports products from the UK, South Africa, and the US. Market investigations found that most New Zealand suppliers supplied products to a large number of companies throughout New Zealand.

113. Imports and domestic engineering/industrial supplies are widely available and there are a large number of suppliers. For instance Paykel has in excess of [] suppliers and Blackwoods has in excess of [] suppliers. Trade Zone currently has [] supply partners.

114. Some competitors raised concerns that the merged entity would have exclusive distribution agreements for specific brands, namely, Goodyear hoses and for Rocol products. However, these are specific brands and there are likely to be substitute products. Further, the merger is unlikely to make access to these specific brands difficult.

115. Branding and reputation of supplying quality products just in time can also be considered to be a barrier to be entry.

The “LET” Test

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

Likelihood of Entry

117. During market investigations the Commission has not been informed of any new entrants wishing to enter the market at this current time. However [] stated that in the past, it has lost four staff, who set up competing companies.

118. Industry participants stated that the market is currently well served with several distributors of engineering/industrial supplies. If the merged entity raised prices by 5% then entry is likely although expansion from existing competitors would be more likely.

Extent of Entry

119. The Applicant stated that entrants can enter the market on any scale in respect of any range of product lines it chooses. A new entrant could enter by setting up a branch in one region either specialising in one product line or by distributing a commonly used range of engineering/industrial supplies.

120. Companies specialising in distributing one type of engineering/industrial product could expand their product range easily. An example of a competitor looking to expand its range is []. It is starting to import electrical switchgear. Further it has obtained a new sales representative in the South Island and is [].

121. Some companies are expanding distribution channels through the internet. Both Blackwoods and Paykel have an on-line catalogue system. Market investigations found that [].

122. An existing competitor could expand by developing trading partnerships. For example, []. Further, companies wishing to expand could join the buying group, Trade Zone. The group would assist in gaining access to a wider range of engineering/industrial supplies as well as buying products at better rates. The group would also assist in the marketing of engineering/industrial supplies to end consumers.

123. The Applicant gave the example of []

].

124. The Commission considers that entry into the market would be sufficient in extent to constrain the merged entity should it attempt to raise prices by 5%.

Timeliness of Entry

125. The Applicant stated that competitors and/or near entrants could enter the market quickly simply by expanding on existing product lines using existing capacity. Such expansion could occur in a matter of weeks and would simply involve securing access to products.

126. Even where there is no such existing capacity, additional capacity could be easily achieved by expanding existing premises, relocating or opening and operating an additional site. This could be expected to take approximately 3 – 6 months.

127. The Commission is of the opinion that entry could be achieved within a time period sufficient to act as a constraint on the merged entity.

Conclusion on Constraint from Potential Competition

128. The Commission concludes that barriers to entry in the distribution of engineering/industrial supplies in each of the 12 regions are low and the likelihood, extent and timeliness of entry are sufficient to act as a constraint on the merged entity.

Other Competition Factors

Constraint from Buyers

129. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

130. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission therefore considers whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

131. Approximately [] of Blackwoods' sales and [] of Paykel's sales are made to large organisations that purchase over [] worth of engineering/industrial supplies.

132. Some of the customers contacted considered themselves to have a strong bargaining position when negotiating price with their suppliers. [] said that they had been successful in negotiating prices with Paykel. Further [] said that whilst the merger may put Blackwoods and Paykel in a powerful position, the merged entity would not want to jeopardise the [] contract it has with [].

133. [] stated that it had regular performance meetings with [] and [] stated that in its contract with [] there were key performance indicators that it had to meet.

134. Market investigations found that customers were content with the choice of suppliers and there were no switching costs that would impede switching. For example, [].

135. It appears that large customers could foster new entry or expansion. [].

136. The merged entity's customers also includes trades people, and to a lesser extent, the "do it yourself" ("DIY") customer. Such purchases are small and on an ad hoc basis. As individuals these customers are unlikely to have countervailing power.

Constraint from Suppliers

137. Some competitors raised concerns that the merged entity would have strong purchasing power to obtain engineering/industrial supplies at low prices. These competitors stated that in the past, Blackwoods and Paykel were able to compete in competitive tenders with low bids because of their purchasing power. In particular, it was claimed that Blackwoods was able to benefit from products imported from its Australia branch.

138. []. This suggests that customers may actually be benefiting from Blackwoods and Paykel's lower prices. Further the suppliers contacted said that the merged entity would not be able to exercise any market power and that they distributed their products widely. For instance, [] sales of cutting tools and hand tools to Blackwoods represented only [] of their sales and sales to Paykels represented only [].

Conclusion from countervailing power

139. The Commission considers that the merged entity would be constrained by countervailing power from large customers and that the acquisition would not result in the merged entity acquiring monopsony power.

OVERALL CONCLUSION

140. The Commission has considered the probable nature and extent of competition that would exist in the regional distribution of engineering/industrial supplies. The Commission has focussed on 12 regions, where the aggregation occurs.

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

142. The Commission has considered the nature and extent of the contemplated lessening of competition. In the distribution of engineering/industrial supplies in each of the 12 regions, where the aggregation occurs, the proposed acquisition would result in the merged entity obtaining a market share which falls within the Commission's safe harbour guidelines.

143. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

- Constraint posed by existing competition;
- Ease of entry by potential competitors; and
- Countervailing power by large purchasers.

144. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the market for the distribution of engineering/industrial supplies, in the geographic regions in which the aggregation occurs.

DETERMINATION ON NOTICE OF CLEARANCE

145. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition of

Dated this 26th day of June 2003

Paula Rebstock
Acting Chair

APPENDIX ONE
MARKET SHARES IN THE DISTRIBUTION OF ENGINEERING/INDUSTRIAL
SUPPLIES IN EACH OF THE 12 REGIONS

Table 1: Market Share for Northland

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC	[]	[]
Donovans Trade Supplies Limited ⁹	[]	[]
BGH Group	[]	[]
Trade Zone	[]	[]
EDL Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 2: Market Share for Auckland

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
BGH Group	[]	[]
Trade Tools	[]	[]
Trade Zone	[]	[]
Hylton Parker Fasteners	[]	[]
Sulco Limited	[]	[]
EDL Fasteners	[]	[]
Waitemata Hydraulics and Engineering Supplies Limited ¹⁰	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

⁹ Owned by individuals in Whangarei

¹⁰ Owned by individuals in Auckland

Table 3: Market Share for Waikato

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
Trade Zone	[]	[]
Trade Tools	[]	[]
BGH Group	[]	[]
EDL Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 4: Market Share for Bay Of Plenty

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
BGH Group	[]	[]
Asmuss Brooking Limited ¹¹	[]	[]
H.K Heaton	[]	[]
Trade Zone	[]	[]
EDL Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

¹¹ Owned and by individuals in Rotoiti and Whakatane and H J Asmuss & Co Limited in Auckland

Table 5: Market Share for Hawke's Bay (including Gisborne)

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
BGH Group	[]	[]
Trade Tools	[]	[]
EDL Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 6: Market Share for Taranaki

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
BGH Group	[]	[]
Trade Zone	[]	[]
EDL Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 7: Market Share for Manawatu/Wanganui

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
Trade Zone	[]	[]
Trade Tools	[]	[]
BGH Group	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 8: Market Share for Wellington (including Wairarapa)

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
BGH Group	[]	[]
Trade Zone	[]	[]
Trade Tools	[]	[]
EDL Fasteners	[]	[]
Hylton Parker Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 9: Market Share for Marlborough/Nelson

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
Nalder & Biddle (Nelson) Limited ¹²	[]	[]
Trade Zone	[]	[]
Russet Engineering Sales Limited ¹³	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 10: Market Share for Canterbury

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
BGH Group	[]	[]
Trade Zone	[]	[]
Russet Engineering Sales Limited	[]	[]
Trade Tools	[]	[]
EDL Fasteners	[]	[]
Hylton Parker Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

¹² Owned by Bertney (No. 12) Limited which in turn is owned by individuals in Nelson

¹³ Owned by individuals in Dunedin

Table 11: Market Share for Otago

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC Limited	[]	[]
Trade Zone	[]	[]
Wilson Bros Limited ¹⁴	[]	[]
Russet Engineering Sales Limited	[]	[]
Hylton Parker Fasteners	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

Table 12: Market Share for Southland

Company	Turnover (\$M)	Market Share %
Paykel	[]	[]
Blackwoods	[]	[]
BOC	[]	[]
Wilson Brothers	[]	[]
Trade Zone	[]	[]
Other	[]	[]
TOTAL	[]	[]
Current 3-Firm Concentration Ratio		[]
Post-Merger 3-Firm Concentration Ratio		[]
Paykel/Blackwoods		[]

¹⁴ Owned by Wilson Bros Holdings Limited which in turn is owned by individuals in Invercargill