

COMMERCE COMMISSION

Decision No. 504

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

BUNGY NEW ZEALAND

and

PIPELINE BUNGY

The Commission: **Denese Bates (Chair)**
Donal Curtin

Summary of Application: The acquisition by Bungy New Zealand Limited (“BungyNZ”) of the business of Pipeline Bungy (“Pipeline”).

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: 24 July 2003

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EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") was received on 4 July 2003. The notice sought clearance for an application from Bungy New Zealand Limited ("BungyNZ") to purchase the business referred to as Pipeline Bungy ("Pipeline") in Queenstown, New Zealand.

Market Definition

2. The Commission concludes that, for the purpose of analysing this application, the relevant market is: The market for the provision of retail adventure tourism activities in the Queenstown Lakes region ("the market").

Counterfactual

3. As BungyNZ and Pipeline have indicated they can and will continue to operate as a going concern if the acquisition does not proceed, the Commission considers the appropriate counterfactual the status quo.

Competition Analysis

Existing Competition

4. Over twenty firms compete in the market. Both bungy operators and other adventure tourism operators stated they are competing for the same tourist dollar. The competitors interviewed indicate that competition is vigorous and driven primarily by the nature of the activity and its price.
5. The number of competitors in the market and the level of competition for the Queenstown tourist dollar indicate that any change in the market post acquisition is likely to be minimal. In any event, Pipeline offers minimal constraint after losing the mantle of "highest bungy" to the Nevis Highwire in 1998.

Barriers to Entry

6. Two bungy operators achieved entry in the last two years in the market. While the resource consent process did take two years for these firms to complete, the fact that they were able to enter suggests that with a sufficient point of differentiation in terms of the activity offered, tourism activity operators can and will enter the market.
7. The Commission concludes that barriers to entry in the adventure tourism activity market are insufficient to prevent new entry.

Overall Conclusion

8. In the market for the provision of adventure tourism activities in the Queenstown Lakes region, 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 competition and potential competition from entry.

THE PROPOSAL

9. A notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") was received on 4 July 2003. The notice sought clearance for an application from Bungy New Zealand Limited ("BungyNZ") to purchase the business referred to as Pipeline Bungy ("Pipeline") in Queenstown, New Zealand.
10. Pipeline has been owned and operated by the Skippers Canyon Joint Venture (the 'Joint Venture'), a joint venture between Ngai Tahu Tourism Limited ("Ngai Tahu") and Skippers Canyon Jet Limited ("Skippers Canyon Jet") since 1996.
11. The proposed purchase by BungyNZ was conditional on Ngai Tahu acquiring 100% of the Pipeline Bungy business by buying the interest of its Joint Venture partner, Skippers Canyon Jet.
12. As such, the Applicant entered into a conditional Sale and Purchase Agreement with Ngai Tahu Limited ('the Vendor') dated the 13th day of March 2003.
13. On 21 July 2003, the Vendor confirmed that it acquired the interest of Skippers Canyon Jet and the Sale and Purchase agreement has now taken affect conditional on Commission clearance.

THE PROCEDURES

14. 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. Accordingly, an extension of time was sought and agreed to by the Applicant. A decision on the application was required by 24 July 2003.
15. In its application, BungyNZ has sought confidentiality for certain aspects of the application involving market share and the purchase price of the target firm. 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.
16. The Commission's determination is based on an investigation conducted by staff.
17. The Commission's approach is based on principles set out in the Commission's Practice Note 4.¹

THE PARTIES

Bungy New Zealand Limited

18. BungyNZ acts as the parent and holding company for the AJ Hackett Bungy brand. Fun Innovators NZ Limited is the sole shareholder in BungyNZ. Henry Van Asch is the sole shareholder in Fun Innovators NZ Limited. BungyNZ currently runs bungy jumping operations predominantly in the Queenstown region. These operations include the

¹ Commerce Commission, *Practice Note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

Kawarau Bungy, Nevis Highwire, The Ledge and Skippers Canyon. BungyNZ is also developing a bungy operation on the Auckland Harbour Bridge.

Pipeline Bungy

19. Pipeline was owned and operated by the Joint Venture, which encompassed Ngai Tahu and Skippers Canyon Jet. The Joint Venture operated bungy jumping, jet boating and scenic trips by four-wheel drive.

20. Ngai Tahu Tourism Limited owns shares in the following companies:

- Shotover Jet Limited—82%;
- Skippers Canyon Holdings Limited—50%;
- Skippers Grand Canyon Limited—51%.

THE INVESTIGATION

Other relevant parties

21. In the course of the investigation of the proposed acquisition, Commission staff have discussed the application with a number of parties.

Other suppliers of bungy activities

Queenstown

- Bungee Rocket is located on the Gorge Road in Queenstown. The Bungee Rocket is a fixed capsule propelled into the air by two bungies attached to fixed towers.



- ParaBungy operates from an elevation of 150-180 metres and claims it is now the highest bungy jump in Queenstown. The ride begins when you stand on the deck of the paracruiser with a towline attached. The participant is belted into a chair and also harnessed to the bungy. As the boat speed increases you are launched into the air. The participant then jumps from the chair with the bungy attached.
- Sunrise Balloons offer balloon flights in the Queenstown region. Sunrise Balloons secured resource consent to offer bungy jumps from a balloon tethered over the Shotover River Valley for three days per week. However, due to the consent conditions it is unlikely that the venture will proceed at this point.

Taupo

- Taupo Bungy is a 5 minute drive from the Taupo town centre. The platform is set against a cliff top 47 metres above the Waikato River, a short distance below the outlet from Lake Taupo.

Canterbury

- Mt. Hutt Bungy is located on the slopes of Mt Hutt Ski Field inland from Christchurch.



Mangaweka

- Mokai Gravity Canyon Bungy is located at Mangaweka and situated over the Rangitikei River.

Suppliers of other adventure tourism activities

Queenstown

- NZONE—tandem skydiving
- Fly by Wire
- Vertigo Mountain Biking
- Anti Gravity Tandem Hang gliding
- Queenstown Tandems—Parapente
- Shotover Jet
- Dart River Jet
- Fat Tyre Adventure
- Totally Tourism, which operates the Helicopter Line, Challenge Rafting, Heliski and Milford Scenic Flights.

Local Councils and Industry Bodies

- Civic Corp provides Resource Management & Regulatory Services to Local and Regional Government. The company was established in 1997 and in 1998 secured a contract with the Queenstown Lakes District Council to provide all resource management and regulatory services for the Council.
- Commerce Queenstown (“CQ”) was founded in 1993. CQ’s role is to represent a wide range of local business interests from international accommodation chains to owner operated retail outlets. CQ provides its members with business information, educational, advocacy and networking services and acts as an advocate for the local business community.

PREVIOUS INVESTIGATIONS

Shotover Jet Ltd/ Helijet, (7 April 1997)

22. In Shotover Jet Ltd/ Helijet the Commission defined separate markets for “thrill seeking jet boat rides” and “eco-tourism jet boat rides”. Separate markets were defined based on the thrill aspect of the Shotover jet boat ride versus the exploration of nature aspect of the ride sold by Helijet. It was considered that the different motivations for selecting these rides justified separate markets.
23. The Commission considered a key element in determining whether certain tourist activities belong in the same market is the rationale for the purchase decision.

Queenstown Rafting Ltd/Kawarau Raft Expeditions Ltd/Makin' Waves the Rafting Company Ltd/Adventure Discovery Ltd. AUT/BA Q3/1, 29 May 1996

24. In this rafting decision, the Commission adopted a conservative market definition for the provision of rafting trips in the Queenstown Lakes region while noting that its investigation had indicated customers may switch between adventure tourism activities in response to relative changes in prices.

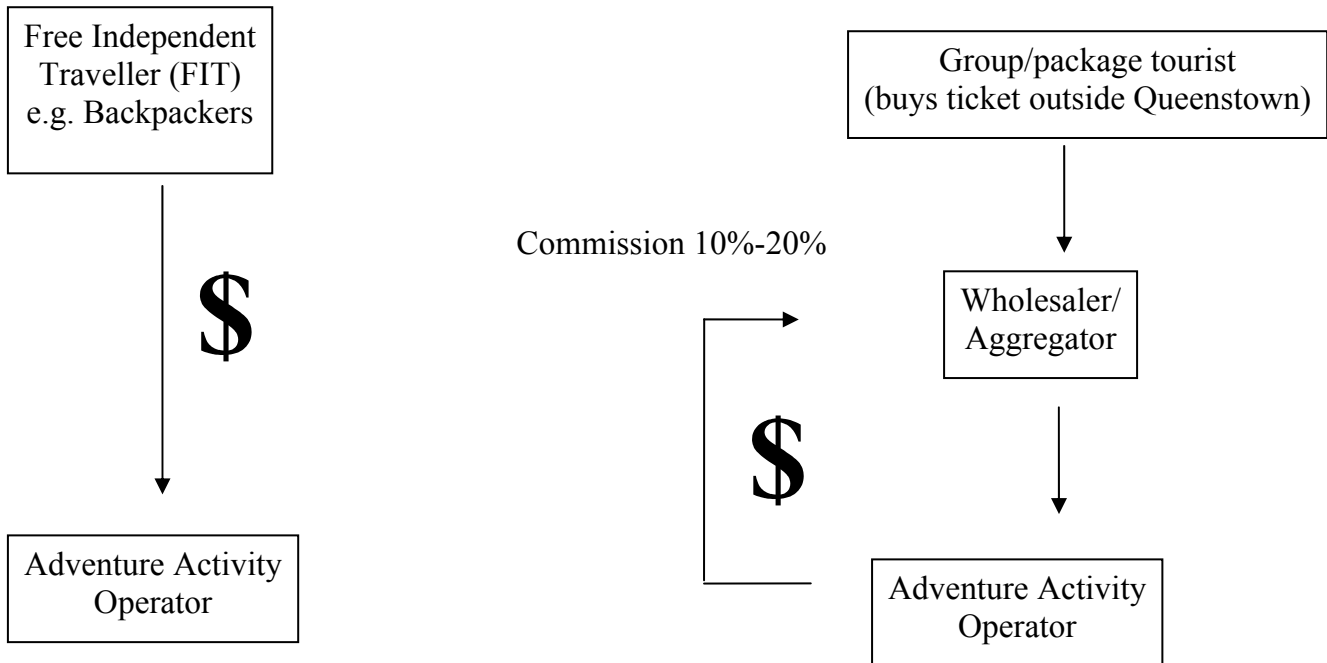
INDUSTRY BACKGROUND

Structure

25. Adventure tourism is a relatively recent phenomenon in New Zealand and industry participants interviewed indicate that Queenstown is considered the birthplace of the industry with the introduction of bungy jumping by AJ Hackett in the early 1990's. Queenstown's moniker as "the adventure tourism capital of New Zealand" reflects the area's attraction for tourists seeking the thrill and adrenalin rush available from adventure activities.
26. Queenstown is the traditional home of bungy jumping in New Zealand. A number of other bungy operations are located throughout New Zealand. According to the Applicant, jump prices range from \$80 to \$200. Interviews with bungy operators nationally confirmed this price range.
27. Bungy jumping is described in the following passage by the Applicant:
- "The bungy operators' crew secure a strong latex rubber cord either to a full body harness or around the jumper's ankles. The jumper hobbles to the edge of a platform and dives into space, free falling until the cord is fully extended. If the jump is over water there is usually a 'splash-down' or 'water touch' option and the jumper is retrieved by boat. Over land, the jumper is hoisted back up to the platform. Other forms of bungy jumping include jumping from hot air balloons and from parasail boats (a parachute pulled behind a boat with a bungy dropping from a platform under the chute)."
28. The bulk of demand for adventure tourism is from tourists (both international and domestic). The market is demand driven and seasonal. Tourists have a large selection of activities to choose from in Queenstown. Activity operators indicate that the winter and summer seasons are the high volume periods with May and June the slowest periods of the year.
29. The number of tourists who visited Queenstown in 2002 according to Tourism New Zealand was 537,424. The average length of a tourist visit to Queenstown is 2 days. The relatively short time period of the average tourist visit means that most tourists are time constrained in relation to the number of activities they can participate in during their stay.
30. Activity operators interviewed stated that because tourists are "time poor" there is stiff competition for the limited number of activity choices a tourist can make during a stay in Queenstown.
31. Operators interviewed indicate there are two primary channels for selling adventure activities to tourists. The first channel relies on activity aggregators (hotels, inbound tour operators, travel agents) who package activities, accommodation and transport for tourists. Typically, these aggregators receive commissions ranging from 10%-20% of the purchase price of the activity. Activity operators indicate that, on average, aggregators account for up to [] of total customers.

32. The second channel involves the activity operator selling directly to tourists. This channel is preferred by activity operators as no commission is paid to third party aggregators. Activity operators in Queenstown typically set up a branded store front in the Queenstown town centre to target tourists.

Table 1: Primary Sales Channels for Adventure Tourism Activities



33. These branded store fronts are used primarily to target the free independent traveller or (“FIT”). The FIT is a tourist who has not come to Queenstown on a packaged tour and has significant amounts of discretionary dollars to spend on selected activities. A typical example of a FIT tourist is a backpacker. While backpackers do not spend significant amounts on accommodation, research conducted by Tourism NZ indicates they are among the top spenders on discretionary activities in Queenstown like bungy jumping and skydiving.

Conduct

34. The Applicant has indicated that brand awareness, reputation for safety, and location of activity are all points of differentiation that industry participants rely on for competitive advantage. A key point of differentiation for bungy jumping is the degree of height offered by an operator. As an example, when the Pipeline Bungy was first set up it was billed as the highest platform for bungy jumping in Queenstown. However, the construction of the Nevis bungy by BungyNZ took this title from Pipeline and as a result Pipeline’s customer volume was reduced significantly in following years.
35. Tourists, when choosing adventure activities, seek out those operations that offer a unique value proposition. The CEO of BungyNZ, David O’Donnell, noted that the strength of BungyNZ’s operation rested on the branding of the Kawarau Bridge as the “birthplace” of bungy jumping in New Zealand, the Nevis bungy as the highest bungy, and the international brand of AJ Hackett.

36. The recent introduction of ParaBungy and its claim to have the highest bungy in Queenstown illustrates the importance of activity operators offering tourists a unique value proposition to differentiate their activity from others in the Queenstown Lakes region.

MARKET DEFINITION

37. 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.

38. 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.

39. 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).

Relevant Market

Product Market

40. The applicant has submitted that while the area of activity that BungyNZ and Pipeline have in common is the supply of bungy jumping, a large number of firms in the Queenstown region offer adventure tourism activities. The Applicant has submitted that these activities are easily substitutable for bungy jumping.

41. These activities include the following:

- Jetboating
- Skydiving
- Parapenting
- Hangliding
- Mountain biking
- 4wd off-roading
- Fly by Wire
- Heliskiing
- White-water rafting

42. The above activities are grouped according to their ability to induce an adrenalin rush or thrill in the participant. The Applicant submitted that the price range for most adventure activities is \$60-\$400. The Applicant has also noted that adventure activities are often sold in a bundle.
43. The Commission has found evidence that supports the Applicant's claims and suggests there is a commonality of requirements across adventure tourism activities that make substitutability likely between these activities. In March 2002, Tourism NZ commissioned a study titled "International Visitor Satisfaction with their New Zealand Experience". The focus of the report was the "adventure tourism product market". The report notes Queenstown visitors stated that "active, adventurous or high risk activities included bungy jumping, white water rafting, skiing/ snowboarding, jet boating, skydiving and paragliding". Within the tourism industry and among tourists there appears a strong perception that a variety of adventure tourism activities compete for the same customer.
44. The Commission considers that assessing the substitutability of other adventure activities for bungy jumping requires using a differentiated product market. Practice Note 4 states:
- "In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.
- In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes".
45. Given this approach, the application of a *ssnip* test of 5% in assessing the substitutability of other adventure tourism activities for bungy jumping is of limited use given the high elasticity of demand typically found in discretionary activities and the differentiated nature of the products.
46. The Commission considers that where a *ssnip* test is inappropriate the following factors should be relied on in determining the appropriate market definition:
- the behaviour of buyers, including analyses of historical and likely future trends, and evidence from consumer surveys;
 - business behaviour, sales strategies and marketing;
 - the views of market participants.
- These factors are analysed below.
47. Tourists appear to consider those activities that offer adrenalin or thrill inducing activities as similar product offerings. This perception is reinforced by the industry practice of packaging activities like bungy jumping, jet boating and white water rafting into a single day's itinerary. Tour activities are also commonly packaged with accommodation and travel packages.
48. Activity operators interviewed emphasised that they view themselves as competing with other activity operators for the scarce amount of time the average tourist spends in Queenstown. The CEO of Shotover Jet, Adrian Januszkiewicz, noted that the average tourist stays in Queenstown for two days. Tourists typically spend one of those days

going to Milford Sound. This leaves the 130 tourism operators in Queenstown to compete for a single day of the tourist's time and discretionary dollar.

49. Shotover Jet provided the Commission with market shares from the full range of activity operators in Queenstown. The ability of Shotover Jet to provide such information reinforces the contention made by Shotover that they compete in the "Queenstown activity market".²
50. On the basis of the adventure tourism operators interviewed by the Commission and the buying behaviour of Queenstown tourists, the Commission considers a market definition that includes the range of thrill/adrenalin inducing activities in Queenstown as best reflecting the competitive dynamic between adventure tourism operators. In previous investigations, the Commission defined narrow markets both in terms of the tourist activity and the region where the activity occurs.
51. If the Commission defined a narrow market, in this case the provision of bungy jumping, it is likely the competitive dynamics between bungy operations and other adventure tourism activities would not be accurately captured.
52. However, while the Commission considers that in this instance bungy is best characterised as being part of a broader adventure tourism market, it does not necessarily follow that this will be the approach the Commission will take in other acquisitions involving adventure tourism providers. In other instances it may be appropriate to define narrower product markets for certain adventure tourism activities.
53. In conclusion, the Commission considers the relevant product market to be adventure tourism activities due to what seems to be a high degree of demand side substitutability between the ranges of activities available in Queenstown.

Further Considerations on the Product Market

54. A further relevant characteristic of the tourism industry is that significant numbers of consumers purchase package tours which typically include accommodation, travel, and activities at the holiday destination. The proportion of consumers purchasing adventure tourism activities in this manner is substantial (see above).
55. The Full Court of the Federal Court of Australia in *Singapore Airlines*³ addressed market definition issues involving a single component of package tours (air travel). In that case French J considers the choice that a consumer (i.e. a buyer at the retail level for packaged tours) would make ("The critical question...") and finds that relevant alternatives are "different island or continental destinations". At paragraph 40, 177 French J states that the lower court did not address, "the extent to which the airlines ability to affect price at the wholesale or resale level would be constrained by the ability of wholesalers and their customers to turn to other destinations".
56. Indeed, such tours are typically sold at a single, all inclusive, price; and are agreed and paid for ex-ante. Tourists who wish to purchase a group/package tour have had the ability to choose from a wide range of packages well before their arrival in Queenstown. Given that adventure tourism activities are a component of such tours, it may be apposite to include the market for package tours in the analysis of the case as well as, at a functional level, the wholesale purchase of adventure tourism activities by tour operators.

²Ibid.

³ *Singapore Airlines Limited v Taprobane Tours WA Pty Limited* (1992) 14 ATPR 41-159

57. The inclusion of such markets in the case would almost certainly reduce any competition concerns (as it did in *Singapore Airlines*) that might arise from the proposed transaction. Accordingly, the approach the Commission takes in this case, consistent with previous practice and its Practice Note 4, is to conduct the analysis on a narrow market definition i.e. without reference to the market for package tours and if the acquisition can be cleared on that, more conservative, basis, it would also be cleared using broader markets.

Functional Market

58. The key focus of the Commission's investigation is the seller-buyer relationship for adventure tourism activities. It is the behaviour of the buyer in response to price increase in adventure tourism activities that is relevant to defining the market. The two parties involved are the activity operator and the tourist. While for some sales an intermediary operates between the activity operator and the tourist, the Commission considers that the essential transaction involves the activity operator and tourist. It is the tourist who ultimately makes a purchase based on perceived value and cost of the activity on offer.
59. Given that this transaction is occurring at the retail level the Commission considers, the relevant functional market is that for the provision of retail adventure tourism activities.
60. The Commission notes that separate functional markets could be established for the FIT sales channel and the packaged tour sales channel. As noted in paragraph 57, such an approach is likely to further reduce competition concerns. Therefore, the Commission considers the single functional market as the conservative approach and if the acquisition can be cleared on this basis the acquisition would also be cleared if the Commission were to use two separate functional markets.

Geographic Market

61. The Applicant has submitted arguments that the market for adventure tourism activities includes Central Otago. However, evidence from industry sources tends to support a narrower geographic definition. Interviews with adventure tourism operators demonstrated that most operators consider the area they compete in as including the greater Queenstown area and Lakes region.
62. Adventure tourism operators interviewed did not indicate that they considered themselves competing with similar activities in other regions of New Zealand. As an example, the Fly by Wire operation in Queenstown has a similar site in Wellington. If the market was geographically defined as a national one, it is unlikely a Wellington tourist is likely to compare the cost of riding on the Wellington Fly by Wire with the cost of the Fly by Wire in Queenstown. It is more likely the tourist will choose between activities after the geographic destination is determined.
63. Activity operators interviewed noted that a significant majority of tourists arrive in Queenstown on packaged tours without personal transport or rental vehicles. These tourists typically move from activity to activity via transportation provided by the tour operator. This arrangement limits both the flexibility of the tourist and the range those tourists are likely to travel during their stay in Queenstown.
64. Tourists are also limited by the duration of their stay. With the average tourist visit to Queenstown of two days it is unlikely most tourists have the time to seek out activities beyond the Queenstown Lakes region.
65. In interviews with Jerry Hohneck, GM of Skippers Canyon Jet, he noted that he considers a radius of 20-30 km emanating outward from the centre of Queenstown as a good

indication of the area adventure tourism operators are competing within. When asked if he would describe the area as the Queenstown Lakes region Mr. Hohneck stated he would.⁴

66. Statistics assembled by Tourism NZ indicate that 1,721,534 tourists arrive in New Zealand annually, of these, 537,424 make the trip to Queenstown. Given the number of tourists travelling specifically to Queenstown and Queenstown's reputation as the adventure capital of New Zealand, tourists are unlikely to compare the product offerings of adventure activities outside the Queenstown region against those in Queenstown when selecting an adventure activity.
67. The General Manager of the Mt. Hutt bungy jump in Christchurch supported the regional market definition as he indicated the majority of his customers come from the greater Canterbury region. "Most of the people who bungy jump on our platform will more than likely be staying in the Canterbury area to go skiing. They won't be going down to Queenstown."⁵
68. Therefore, the Commission considers the appropriate market to be the Queenstown Lakes region which can generally be described as encompassing the area within the Queenstown District Lakes Council area.

Conclusion on the Relevant Markets

69. The Commission concludes that, for the purpose of analysing this application, the relevant market is as follows: The market for the provision of retail adventure tourism activities in the Queenstown Lakes region ("the market").

FACTUAL

70. 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.
71. In the factual scenario BungyNZ, ParaBungy, and Bungee Rocket will be the only bungy specific operators in Queenstown. BungyNZ has advised the Commission that the primary reason for the acquisition is to [].

COUNTERFACTUAL

72. The applicant has not suggested a counterfactual in its clearance.
73. []

⁴ Note for File, Skippers Canyon Jet, 15 July 2003.

⁵ Note for File, Mt. Hutt Bungy, 11 July 2003.

into context, BungyNZ advised that at their Kawarau site they average during the peak season up to [] jumpers per day.

74. [

]

75. However, in interviews with both the Applicant and target firm, both companies stated that if the acquisition did not proceed the business would continue to operate.

76. The Commission will consider information regarding Pipeline's [] in its assessment of the competitive constraint the current operation exerts on other bungy and adventure activities. Pipeline has indicated it can continue to operate as a going concern if the acquisition does not proceed, therefore, the Commission considers the appropriate counterfactual to be the status quo.

COMPETITION ANALYSIS

77. 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.⁶

78. 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.⁷

79. 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'

80. 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

⁶ 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.

⁷ See the Commission's Practice Note 4 for further explanation of the Commission's approach to market share.

- 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%.

Market Concentration

81. As the Commission has defined a market for adventure tourism activities in the Queenstown Lakes region, the Commission intends to use annual turnover of adventure tourism operators as the appropriate measure of market share. While the market shares are different according to the measures used, turnover versus customer numbers, the Commission intends to take a conservative approach and use the turnover figures, as this measure results in the highest level of aggregation.

Table 2: Market Shares for Adventure Tourism in the Queenstown Lakes Region

Activity	Customers	Average Price	Turnover	Market Share Based on \$	Market Share Based on Customers
Total Skiing	[]	[]	[]	[]	[]
Shotover Jet	[]	[]	[]	[]	[]
AJ Hackett	[]	[]	[]	[]	[]
Pipeline Bungy	[]	[]	[]	[]	[]
Merged Entity	[]	[]	[]	[]	[]
Dart River Safaris	[]	[]	[]	[]	[]
Kawarau Jet	[]	[]	[]	[]	[]
Skyline Luge	[]	[]	[]	[]	[]
Queenstown Combos	[]	[]	[]	[]	[]
Tandem Para Gliding	[]	[]	[]	[]	[]
Challenge Rafting	[]	[]	[]	[]	[]
Queenstown Rafting	[]	[]	[]	[]	[]
Twin Rivers Jet	[]	[]	[]	[]	[]
Sky Diving	[]	[]	[]	[]	[]
Offroad Adventures	[]	[]	[]	[]	[]
Total Hang Gliding	[]	[]	[]	[]	[]
Total Horse Treks	[]	[]	[]	[]	[]
Extreme Rafting	[]	[]	[]	[]	[]
Fly by wire	[]	[]	[]	[]	[]
Dart Wilderness Jet	[]	[]	[]	[]	[]
Paraglide	[]	[]	[]	[]	[]
Monster Mountain Rally	[]	[]	[]	[]	[]
Actionflite	[]	[]	[]	[]	[]
Canyon Swing	[]	[]	[]	[]	[]
Bungy Rocket	[]	[]	[]	[]	[]
Rally Karts	[]	[]	[]	[]	[]
Others	[]	[]	[]	[]	[]
Para Bungy	New Entrant				
TOTAL	[]	[]	[]	100%	100%

82. BungyNZ has an [] market share based on total revenue and Pipeline a [] market share. These market shares combined post acquisition fall within the Commission's safe harbour guidelines.
83. However, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include the constraint provided by existing or potential competitors as well as other competition factors such as the countervailing power of buyers and suppliers. These are considered for the relevant market in subsequent sections.

Existing Competition

84. Industry participants have stated that there are at least twenty providers of adventure tourism activities in the Queenstown Lakes adventure tourism market. Notable participants include Totally Tourism, Shotover Jet, NZONE, Queenstown Rafting, Fly by Wire, Queenstown Tandems and ParaBungy.
85. Industry participants stated the level of demand in the market is steady, but prone to seasonal fluctuations with troughs from May to June and peaks from July to September (winter) and December to April (summer), depending on the nature of the adventure activity. Most firms considered that competition in the market is mainly on the basis of price. However, Shotover Jet considered that competition was also on the basis of time, as visitors to the Queenstown region only stay for an average of two days. Shotover Jet considered that this meant adventure activity providers are competing for a customer's time as well as money.
86. [] considered that customers would not switch due to an increase in price, and suggested that bungy was sufficiently differentiated from other activities so that a *snip* test would be profitable. However, most industry participants considered that if Bungy NZ increased the prices of bungy jumping post acquisition, customers would switch to other activities in the region. Most market participants indicated that the price of adventure activities are highly competitive and could not see how the Pipeline acquisition could result in the ability of BungyNZ to substantially increase the price of bungy jumping.
87. In comparing the effects of the acquisition against the counterfactual, the impact on the price of bungy jumping or other adventure tourism activities is likely to be minimal as Pipeline has become a marginal competitor in the Queenstown Lakes region after losing the mantle of 'highest bungy' in 1998 as evidenced in Table 3. Pipeline is presently closed during the winter months and averaging only [] jumpers a day during the summer.
88. As a result of this, Pipeline does not act as a significant constraint on the price of bungy jumping or other adventure activities in the Queenstown Lakes region.

TABLE 3: National Market for Bungy Jumping as Submitted by the Applicant

Rank	Supplier	Owner(s) of supplier	Estimated % of market sales
1	AJ Hackett Bungy	Bungy New Zealand Limited	[]
2	Taupo Bungy	Taupo Bungy and Scenic River Cruises Limited	[]
3	Thrillseekers Canyon (Hanmer Springs)	Thrillseekers Canyon Limited	[]
4	Pipeline Bungy	Skippers Canyon Joint Venture	[]
5	ParaBungy	ParaBungy NZ Limited	[]

89. The fact that Bungy NZ's bungy prices are competitive with prices of other bungy firms both in Auckland, Rotorua and Taupo, and comparable with other adventure activities in the Queenstown Lakes region suggests that existing competition acts as a significant constraint on the behaviour of firms in this market.

Conclusion on Existing Competition

90. The Commission considers that the level of existing competition does not substantially change post acquisition due to the fringe nature of the Pipeline presence in the market. Even if this were not the case, the competitive nature and numbers of other providers of adventure tourism activity pose a significant constraint on the actions of Bungy NZ post acquisition.

Potential Competition

91. 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.

92. 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.

93. 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.

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

lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Barriers to Entry

95. The Applicant estimates that a capital outlay of approximately \$1,000,000 is required to set up a bungy operation. This would include the resource consent process, establishment of suitable facilities, purchasing suitable equipment, and the hiring and training of labour. Entry into other types of adventure activities is of variable cost depending on the nature of the activity. For example, Bungee Rocket's start up costs totalled [], while the cost of establishing Jetboating activities would be substantially more. These requirements (except for specific equipment) are generic to the many adventure activity providers so it is likely there would be a very small sunk cost component, if any, should a new entrant fail.
96. One potential barrier to entry in the adventure tourism market is the requirement for providers to gain resource consent under the Resource Management Act 1991. Bungee Rocket stated that its resource consent process took 3 years and cost [], which included an appeal to the Environment Court. Other industry participants stated that it takes between one to two years to complete the consent process or up to three years if there is an appeal to the Environment Court.
97. A recent attempt to establish a balloon bungy in the Shotover River Valley was appealed through the Environment Court. While the court granted the consent, it was on the basis that the bungy operate for only three days of the week. The parties behind this venture considered that these limitations made the balloon bungy commercially non-viable.
98. However, while the consent process is an obstacle to entry into the adventure tourism market, the presence of a large range of adventure activity providers in the Queenstown Lakes region suggests that the consent process is not a substantial barrier to entry. The Commission considers that, while the resource consent process is an obstacle to overcome in establishing an adventure tourism activity, all entrants to the market face the same obstacle and the evidence of a large number of market participants suggests that it is not particularly onerous. Also, once gained, the resource consent is assignable and therefore does not represent a sunk cost in an absolute sense.
99. The brand name "AJ Hackett" is well known throughout New Zealand. AJ Hackett is a particularly strong brand, having been in the market since the early 1990's when AJ Hackett established the bungy industry in New Zealand.
100. However, the Commission does not believe this would significantly inhibit a current or potential competitor's ability to compete in the adventure tourism market. Evidence from industry sources suggests that the market is primarily price driven. In addition, there are a range of similarly strong brand names in the market, such as Shotover Jet or the brands that come under the Totally Tourism umbrella that serve to mitigate the strength of the AJ Hackett brand name.

Likelihood of Entry

101. Likelihood of entry is evidenced by the amount of entry shown in this market. This includes Bungee Rocket (2001) and ParaBungy (2003), amongst other adventure activities.

Extent of Entry

102. New or existing participants into the adventure tourism market are not limited in their capacity to expand. Participants face no binding capacity constraints and additional capacity is not significantly more expensive to acquire or operate. As an example of this, ParaBungy believes that it will enter the market to a significant extent during the summer of 2003-2004 and generate revenue of over [].
103. The Commission considers that entry or expansion into the adventure tourism market would be sufficient to constrain the merged entity should it gain and attempt to exercise market power.

Timeliness of Entry

104. Given the amount of equipment and capital required to start an adventure tourism business a new entrant could establish a presence well under the Commission's two year time frame. Although the resource consent process could potentially extend this timeframe to up to three years, this is an obstacle faced by all industry participants.

Conclusion on Constraint from Potential Competition

105. The Commission concludes that barriers to entry in the adventure tourism market are insufficient to prevent new entry.

Modelling Effects of the Merger

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

Diversion ratio calculations⁸ ... have been incorporated into ... software that generates a Bertrand-Nash equilibrium in prices for a given merger.⁹ This software was developed according to specifications set out in a recent paper by Epstein and Rubinfeld¹⁰. In the paper, they propose a technique based on Deaton and Muellbauer's "Almost Ideal Demand System" (AIDS)¹¹ that is calibrated by market shares. Hence it carries the moniker, Proportionality Calibrated AIDS or PCAIDS. 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.

107. The model requires as inputs the following:

- brand market shares (as measured by revenue);
- the market price elasticity of demand;

⁸ See Carl Shapiro, "Mergers with Differentiated Products", *Antitrust Law Journal*, spring 1996, pp. 23-30.

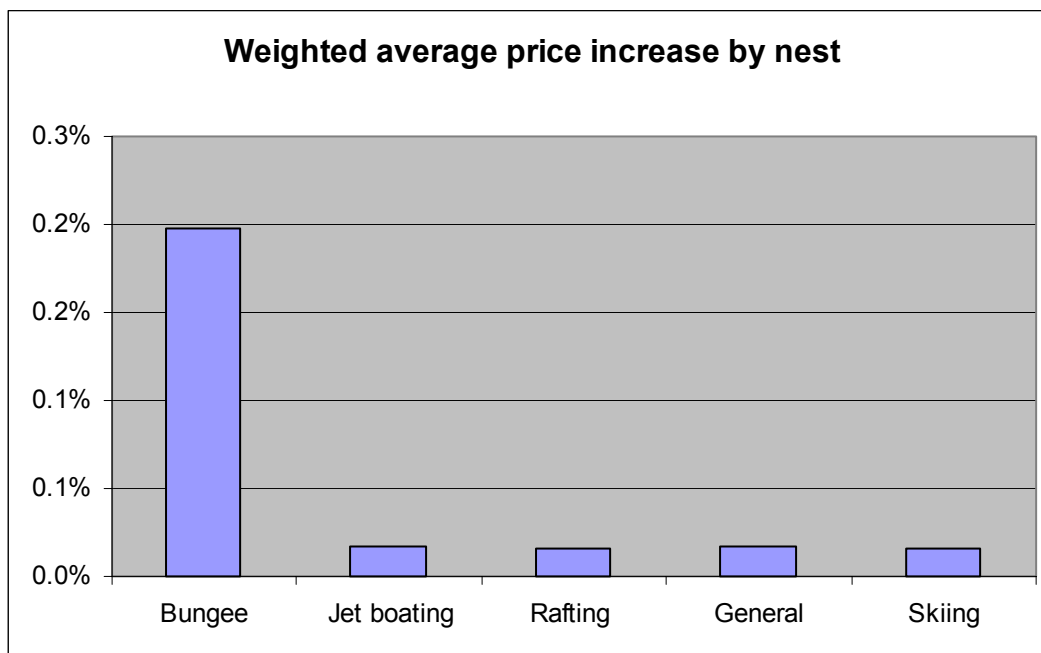
⁹ For a full exposition see Jean Tirole, *The Theory of Industrial Organization*, Harper Collins, 1988, chapter 7.

¹⁰ Roy Epstein and Daniel Rubinfeld, "Merger Simulation: A Simplified Approach With New Applications", *Antitrust Law Journal*, vol. 69, pp. 883-919.

¹¹ Angus Deaton and John Muellbauer, "An Almost Ideal Demand System", *American Economic Review*, June 1980, pp. 312-26.

- the own price elasticity of demand of one of the brands in the market; and
- attribution of brands to different “nests” to reflect a degree of substitutability between groupings of brands that is considered to be warranted but is not reflected in the market share data.

108. Activities were put into five separate nests being bungy, jet boating, rafting, skiing, and a general category. These were configured to restrict cross nest substitutability to 75% of what it would be without nests except in the case of skiing, the substitutability of which was reduced to 50% of what it would be based on market shares. This seemed appropriate given that skiing is only available as a substitute during the winter months. A run of the model using an estimate of -1 for market elasticity and -4 for the Applicant’s bungy offering indicated that the pipeline bungy might be able, after the merger, to increase its prices by about 2% and that bungy operators might be able to increase average prices by 0.2%.



109. These modelling results support the Commission’s findings that existing and potential competition will constrain the merged entity from raising prices post acquisition.

OVERALL CONCLUSION

110. The Commission has considered the probable nature and extent of competition that would exist in the market for: the provision of retail adventure tourism activities in the Queenstown Lakes region (“the market”).
111. The Commission considers that the appropriate counterfactual for comparison is the status quo.
112. The Commission has considered the nature and extent of the contemplated lessening. In the supply of adventure tourism activities in the Queenstown Lakes region, the proposed acquisition would result in the merged entity obtaining a market share which falls within the Commission’s safe harbour guidelines.
113. 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.

114. 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 provision of retail adventure tourism activities in the Queenstown Lakes region.

DETERMINATION ON NOTICE OF CLEARANCE

115. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition of Pipeline Bungy by Bungy New Zealand Limited.

Dated this 24th day of July 2003

Denese Bates
Division Chair