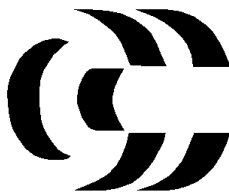


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## COMMERCE COMMISSION

### Commerce Commission

### Decision No. 350

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

**SIGMA COMPANY LIMITED**

**and**

**AMCAL CHEMISTS MARKETING LIMITED**

**The Commission:** K M Brown

**Summary of Application:** Acquisition by Sigma Company Limited, or an interconnected body corporate, of up to 100% of the shares in Amcal Chemists Marketing Limited

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

**Date of Determination:** 6 April 1999

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## THE PROPOSED ACQUISITION

- 1 Pursuant to section 66(1) of the Commerce Act 1986 (the Act), Sigma Company Limited (Sigma) gave notice to the Commission on 19 March 1999 (the application) seeking clearance for the proposed acquisition by it or an interconnected body corporate of Sigma of up to 100% of the shares in Amcal Chemists Marketing Limited (Amcal Chemists). Sigma stated that acquirer will be Sigma Retail Services NZ Limited, a wholly owned subsidiary.

## THE PARTIES

### Sigma

- 2 Sigma is a long-established Australian company which has its head office in Melbourne. The company's activities in Australia include drug research and development, the manufacture of prescription and over-the-counter products, and the wholesaling of pharmaceutical products. Sigma is the second largest pharmaceutical wholesaler in Australia. Sigma operates the *BodyRight* pharmacy banner group in South Australia and Western Australia, and the *NQ Chemists* and *Sunshine* banner groups in Queensland. In May 1997 the company acquired the *Guardian* banner group, bringing its total number of banner group members in Australia to about 400.
- 3 Sigma has expanded quickly in New Zealand in the past year, principally through acquisitions. In 1998 the company acquired the *Pharmacycare* banner group, which had been established in 1994, and later in 1998 launched the *Guardian* banner group in New Zealand. Sigma acquired a pharmaceutical wholesaler in Auckland in August 1998 and another in Wellington in February 1999. Sigma's New Zealand subsidiary, Sigma NZ Limited, has three subsidiaries. These are Russells Pharmaceuticals Limited and Pharmacy Wholesalers Wellington Limited, which wholesale pharmaceuticals in Auckland and Wellington respectively. The third subsidiary, Sigma Retail Services NZ Limited, operates the *Guardian* and *Pharmacycare* retail banner groups and the *PPS* buying group. Sigma is the proprietor of the AMCAL brand in Australia and New Zealand.

### Amcal Chemists

- 4 Amcal Chemists was established in 1988, and is registered under the Co-operative Companies Act. The company has 86 members who operate retail pharmacies throughout New Zealand. The Amcal brand name is used in New Zealand by Amcal Chemists under licence from Allied Masters Chemist of Australia Limited, a wholly owned subsidiary of Sigma.

## PROCEDURES

- 5 The application was registered by the Commission on 19 March 1999. Section 66(3) of the Commerce Act requires that the Commission, within 10 working days after the

date of registration of the application, or such longer period agreed by the Commission and the applicant, gives, or declines to give, a clearance for the acquisition. The tenth working day after the registration of the application was 6 April 1999.

- 6 Sigma advised the Commission that it did not seek a confidentiality order for the fact of the application, but that it did require confidentiality for some specific information contained in the application. A confidentiality order was granted in respect of that information, and this will remain in force until 20 working days after the date of this determination. When the order has expired, the provisions of the Official Information Act 1982 will apply.
- 7 The Commission's determination is based on an investigation conducted by Commission staff and their subsequent advice given to the Commission.

## **THE INVESTIGATION**

- 8 In the course of their investigation of the proposed acquisition, Commission staff have discussed the application with a number of parties, including:
- Amcal
  - Health Funding Authority
  - Researched Medicines Industry Association of New Zealand Incorporated
  - Unichem
  - Pharmaceutical Management Agency Limited (Pharmac)
  - The Pharmacy Guild of New Zealand Incorporated
  - Zeullig Pharma New Zealand Limited
- 9 In addition, staff have sought and received comment and further information to that contained in the application from Sigma.

## **MARKET DEFINITION**

### **Introduction**

- 10 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in terms of s 47(1) of the Act, in any market.
- 11 Section 3(1A) of the Act provides that:

... the term 'market' is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.

- 12 The Commission's Business Acquisition Guidelines provide information on how the Commission approaches the task of market definition.<sup>1</sup> A brief discussion of this approach follows.
- 13 Markets are defined in relation to product type, geographical extent, and functional level. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products or across geographical regions in response to a change in relative prices of the products concerned. A market is the smallest area in which all such substitution possibilities are encompassed. It is in this area that a hypothetical monopoly supplier could exert market power.
- 14 A properly defined market will include products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension). A market defined in these terms is one within which a hypothetical profit-maximising sole supplier of a product could impose at least a small yet significant and *non-transitory* increase in price (the "*ssnip*" test), assuming other terms of sale remain unchanged. It will also include those suppliers currently in production who are likely, in the event of such a *ssnip*, to shift promptly to offer a suitable alternative product, or offer their product to alternative acquirers.
- 15 Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products proceeds through a series of vertical functional levels, so the functional levels affected by the application have to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the "manufacturing market", while that between wholesalers and retailers is usually known as the "wholesaling market".
- 16 In the application, Sigma defined the relevant market as that for "the provision of distribution, marketing and retailing services to retail pharmacies throughout New Zealand". The exact services which are available will depend on the rules of the group. The application notes the differences in the terms of membership between the *Guardian* and *Pharmacycare* banner groups and the *PPS* buying group. The services which may be provided to banner group members include access to more favourable buying terms than those available to independent firms, the benefits of group advertising, the acquisition of the banner group's "image", and access to support services such as training and development, design and store fit-out.
- 17 Ownership of pharmacies is not changed by the proposal, and, under the existing legislation, could not be. The effect of The Pharmacy Act 1970 is that effective control of a pharmacy must remain with a pharmacist or pharmacists, that the owner/s of one pharmacy may not also own other pharmacies, and that wholesale pharmacy companies may not own retail pharmacies.

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<sup>1</sup> Commerce Commission, *Business Acquisition Guidelines* 1996, pp 11-16

- 18 The product market description provided by Sigma appears to be a good general description of the nature of the services provided by the company's to pharmacy retailers. Banner groups may operate nationally, as Amcal and Unichem do, or they could operate in a more limited geographic region. However, even if a group chose the latter course, there would be no reason why it could not later extend its coverage. A New Zealand-wide geographic market appears appropriate.

### **Conclusion on market definition.**

- 19 The Commission concludes that the relevant markets are those for: the provision of organisational services to retail pharmacies in New Zealand, the wholesaling of prescription, restricted and pharmacy-only medicinal drugs in New Zealand and the retailing of prescription, restricted and pharmacy-only medicinal drugs in localities throughout New Zealand.

## **COMPETITION ANALYSIS**

### **Competition Analysis Overview**

- 20 Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance for a proposed acquisition if it is satisfied that the proposed acquisition would not result, and would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.
- 21 Section 3(9) of the Act states that a person is in a "dominant position" in a market if:
- ... a person as a supplier or an acquirer of goods or services either alone or together with an interconnected or associated person is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market ...
- 22 That section also states that a determination of dominance shall have regard to:
- market share, technical knowledge and access to materials or capital;
  - the constraint exercised by competitors or potential competitors; and
  - the constraint exercised by suppliers or acquirers.
- 23 In reaching a view on whether a person is in a position to exercise a dominant influence in a market, the Commission considers the foregoing non-exhaustive factors and any other relevant matters that may be found in a particular case.
- 24 In the Commission's view, as expressed in the Business Acquisition Guidelines 1996<sup>2</sup>, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:

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<sup>2</sup> Ibid p 17

- the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
- the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share.

25 In *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, the Court of Appeal approved the following dominance standard, adopted by McGechan J in the High Court:

... dominance involves more than “high” market power; more than mere ability to behave “largely” independently of competitors; and more than power to effect “appreciable” changes in terms of trading. It involves a high degree of market *control*. (emphasis in original).

### **Pharmacy retailing**

- 26 The Pharmacy Act 1970 provides that every pharmacy must be under the supervision of a pharmacist, and, as indicated above, that ownership and effective control must remain with pharmacists. All pharmacists must be members of the Pharmaceutical Society of New Zealand, which combines the function of a registration board and a professional body<sup>3</sup>.
- 27 The business of pharmacies may be viewed as falling into at least three categories. These would include the dispensing of medicines prescribed by medical or other authorised practitioners, the sale of over-the-counter medical products and the sale of a wide range of other goods and services. There has been an increase in the range of professional services offered by pharmacies, such as reviews of patient medication, which services are purchased by the Health Funding Authority.
- 28 Section 3 of The Medicines Act 1981 defines three categories of medicinal drugs which are declared by regulation or by a notice given under section 106 of the Medicines Act. These categories are prescription medicines, restricted medicines and pharmacy-only medicines. A prescription medicine can be supplied only pursuant to a prescription by an authorised person. A restricted medicine can be supplied only by a pharmacist in a pharmacy or hospital, while a pharmacy-only medicine can be supplied only by premises with a licence to sell medicinal drugs. Pharmacies therefore have a legal monopoly in respect of the retail supply of medicines in these three categories.
- 29 For the dispensing of prescriptions, the dispensing fee is set in terms of the contract between the pharmacist and the Health Funding Authority. The existing contracts are for three year terms and are similar in scope. There are some differences in payment

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<sup>3</sup> New Zealand Official Year Book 1998, page 161

amounts, this being the result of the operation of the Regional Health Authorities before the formation of the Health Funding Authority.

- 30 In the case of restricted and pharmacy-only medicines the pharmacist is responsible for setting the retail price.
- 31 For medical or health products which are not in the categories confined to pharmacies, the pharmacies face competition from other retailers, including supermarkets. In the case of other goods and services, such as cosmetics, toiletries, photographic film and film processing, pharmacies face competition from a range of other retailers. Competition concerns are therefore unlikely to arise for either non-restricted medical products and miscellaneous goods and services.
- 32 There are currently 993 retail pharmacies in New Zealand,<sup>4</sup> the number having fallen a little in recent years, particularly as a consequence of amalgamations designed to obtain operating improvements and the more effective use of professional staff. About 300 pharmacies are members of banner groups.
- 33 At present Unichem is the largest banner group, with 124 members throughout New Zealand. Most of these (110) operate as *Unichem* pharmacists, while 14 operate as *Unichem Life*. The latter are larger outlets, which generally operate in major shopping malls. Unichem is controlled by its members, although Zeullig New Zealand Limited, which provides a national wholesale pharmaceutical service, has a minority shareholding in it.
- 34 The effect of the proposal would be that the three banner groups which would be managed by Sigma would have a somewhat larger total membership than Unichem, with 156 members. (*PharmacyCare* 76, *Guardian* 12 and *Amcal* 86.) However, about 700 pharmacies do not belong to any banner group. Members of the three Sigma banner groups would face competition from Unichem members and from the much greater number of independent pharmacies. There would be a likely to be a significant number of competitors in major centres, but the pattern could vary in small centres.
- 35 A number of people who gave views to the Commission suggested that an increase in the proportion of pharmacists who belong to banner groups is likely, because of increased recognition of the advantages which membership offers. Sigma's annual report for 1997/98 states that the company has a target of 100 *Guardian* banner group members within three years.
- 36 Pharmacies which are members of banner groups are not bound to buy exclusively from the wholesaler which is associated with their group. This applies to both Sigma and its banner groups, and to Zeullig and the two Unichem banner groups. Sigma noted that the exceptions to non-exclusivity are house brands (that is *Guardian* and *Amcal* branded products), which comprise a small part of total sales, and purchases for organised promotions. Wholesalers endeavour to obtain orders from their banner group members through their pricing policies and price incentives.

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<sup>4</sup> The Pharmacy Guild of New Zealand Inc.



- 37 In addition to the existence of banner groups, many pharmacies are members of buying groups. These groups allow their members to buy on more favourable terms, and the members trade otherwise as independent firms. Many of these groups appear to be of an informal nature.
- 38 While most of the prescription and over-the-counter drugs sold by pharmacies are obtained from the pharmacy wholesalers, some lines are supplier direct by the importers or manufacturers. The majority of medicines sold in New Zealand are imported, usually from large international companies, but there are three substantial domestic manufacturers: Douglas Pharmaceuticals, Pacific pharmaceuticals and PSM Healthcare,(a subsidiary of Zeullig New Zealand Limited). Sigma states that in 1998 12.8% of manufacturers' sales were direct to retail pharmacies. Sigma further stated that such sales tend to be of high volume products and that manufacturers could not efficiently by-pass the wholesalers for the whole of their product ranges.
- 39 While pharmacies carry some stocks, they require a high standard of service from wholesalers to allow them to fill prescriptions in a timely way, and twice-daily deliveries are usual. The speed of delivery required limits the geographic coverage which is practicable from a wholesale warehouse.
- 40 Pharmacists may discontinue their membership of a banner group by giving the period of notice prescribed in the group's rules, if any, and returning material provided by the group such as signs, uniforms and training manuals. The Amcal Chemists agreement requires three month's notice. It is therefore open to banner group members to withdraw from their existing group and join another group, or to belong to no group.

### **Countervailing Power**

- 41 In respect to prescription drugs the Health Funding Authority (HFA) has considerable countervailing power through its role in negotiating dispensing fees in its contracts with pharmacies. The contracts include the provision that pharmacists must be able to fill 90% of prescriptions within one hour, and 100% within 24 hours. Pharmac has considerable countervailing power in respect of the wholesale prices of prescription medicines.

## **Vertical Integration**

- 42 A consequence of the proposal would be a strengthening of Sigma's existing vertical integration. Subject to the exceptions of house branded products and goods featured in promotions, Sigma's banner group members are not obliged to obtain their supplies from Sigma. However, it would be natural for Sigma to endeavour to obtain as much business as possible from the members of the groups which it operates, through its pricing policies. About 85% of Sigma's sales go to pharmacies, with less than 15% going to hospitals.
- 43 Sigma estimates that its subsidiaries Russells Pharmaceuticals Limited and Pharmacy Wholesalers Wellington Limited account for [ ] of the wholesale distribution of pharmaceuticals in the North Island and [ ] of the national total. In the wholesale markets Sigma faces competition from Zeullig Pharma Limited, which is the only supplier providing national coverage, and from a small number of regional wholesalers. For some products, Sigma faces competition from importers and manufacturers who sell direct to pharmacy retailers.
- 44 Group members remain free to buy elsewhere and would be likely to do so if they could obtain more favourable terms. They are also able to change their group membership if they wish. Most retail pharmacies do not belong to any buying group, although many belong to informal buying groups which will purchase from the supplier able to offer the best terms. Zeullig Pharma is a substantial competitor. Given these factors, any strengthening of vertical integration which might result from the proposal does not appear likely to hinder competition at either the retail or wholesale level.

## **CONCLUSION**

- 45 The Commission has considered the impact of the proposal in the markets for the provision of organisational services to retail pharmacies in New Zealand, the wholesaling of prescription, restricted and pharmacy-only medicinal drugs in New Zealand, and the retailing of prescription, restricted and pharmacy-only medicinal drugs in localities throughout New Zealand.
- 46 Having regard to the factors set out in section 3(9) of the Commerce Act and all the other relevant factors, the Commission is satisfied that the proposal would not result, or would not be likely to result, in Sigma or any other person acquiring or strengthening a dominant position in any market.

## **DETERMINATION ON NOTICE OF CLEARANCE**

- 47 Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission gives clearance for the acquisition by Sigma Company Limited, or an interconnected body corporate, of up to 1005 of the shares in Amcal Chemists Marketing limited.

Dated this                    day of April 1999

K M Brown  
The Commission