Public Version
ISSN NO. 0114-2720
J7517

COMMERCE COMMISSION

Commerce Commission

Decision No. 571

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

GE FINANCE AND INSURANCE LIMITED

and

PACIFIC RETAIL SERVICES LIMITED, PACIFIC RETAIL FINANCE LIMITED, MONTREAL FINANCIAL SERVICES LIMITED AND SIMPLY INUSURANCE LIMITED

The Commission: Paula Rebstock
David Caygill
Anita Mazzoleni

Summary of Application: The acquisition by GE Finance Limited of the business and assets of the Pacific Retail Finance Group: Pacific Retail Services Limited; Pacific Retail Finance Limited Montreal Financial Services Limited and a 100% shareholding in Simply Insurance New Zealand Limited.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for GE Finance Limited to acquire the Pacific Retail Finance Group.

Date of Determination: 18 January 2006

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EXECUTIVE SUMMARY

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 18 November 2005. GE Finance and Insurance Limited sought clearance to acquire the Pacific Retail Finance Group, namely: the business and assets of Pacific Retail Services Limited; Pacific Retail Finance Limited; Montreal Financial Services Limited and a 100% shareholding in Simply Insurance New Zealand Limited.

2. There is aggregation in consumer insurance products, merchant finance products and personal loans products. The aggregation in the consumer insurance market is very limited (less than 1% of the market), well within the Commission's safe harbours. The Commission was satisfied that the proposed acquisition would not have, nor be likely to have, the effect of substantially lessening competition in the national consumer insurance market.

3. The Commission considers that the relevant markets are the national markets for the provision of:

   - consumer finance products; and
   - merchant finance products to retailers.

4. In the factual scenario, GE Finance would acquire Pacific Retail Finance. Consequently, the combined entity would continue to operate in each of the relevant markets.

5. The Commission considers that the likely counterfactual scenario is the acquisition of Pacific Retail Finance by either a party not already participating in the merchant finance market, or one that has a significantly smaller presence than GE Finance.

6. In the consumer finance market, the aggregation of GE Finance and Pacific Retail Finance would be small in comparison to the rest of the market. The aggregation is well within the Commission's safe harbours and the combined firm would be constrained by existing competition. Accordingly, the Commission considers that the acquisition would be unlikely to substantially lessen competition in the national consumer finance market.

7. In the national market for the provision of merchant finance products to retailers, the Commission considers that the combination of existing competition and countervailing power of retailers would be likely to constrain the combined entity post-acquisition. The retailers are able to exert countervailing power by:

   - swapping finance providers;
   - self supply; and
   - not offering interest free deals.

8. The Commission's view is that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in either the national consumer finance products market or the merchant finance for retailers market.

9. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance of the proposed acquisition by GE Finance and Insurance Limited of the Pacific Retail Finance Group.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 18 November 2005. GE Finance and Insurance Limited sought clearance to acquire the Pacific Retail Finance Group, namely: the business and assets of Pacific Retail Services Limited; Pacific Retail Finance Limited; Montreal Financial Services Limited and a 100% shareholding in Simply Insurance New Zealand Limited.

2. The aggregation in respect of the provision of consumer insurance, is very limited (less than 1% of the market), well within the Commission's safe harbours. As the aggregation is minimal, it is unlikely to give rise to competition issues and accordingly the Commission did not consider it warranted further investigation.

PROCEDURE

3. Section 66(3) of the Act requires the Commission either to clear or decline to clear the acquisition referred to in the s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. A time extension was agreed between the Commission and the Applicant. Accordingly, a decision was required by 20 January 2006.

4. 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 date of the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

5. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's *Mergers and Acquisitions Guidelines*.[1]

STATUTORY FRAMEWORK

6. Under s 66 of the Act, the Commission is required to consider whether the proposal will have, or is likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely, if the Commission is not so satisfied, it must decline clearance. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

7. The substantial lessening of competition test was considered by the High Court in *Air New Zealand v Commerce Commission (No 6)*: [3]

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

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.
[2] *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.
[3] (2004) 11 TCLR 347, [42].

would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.

8. In determining whether there is a change along the spectrum that is significant the Commission must identify a real lessening of competition that is not minimal.[4] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

9. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years or some other timeframe as appropriate in any given case.

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

ANALYTICAL FRAMEWORK

11. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:

   - with the acquisition in question (the factual); and
   - in the absence of the acquisition (the counterfactual).

12. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:

   - existing competition;
   - potential competition; and
   - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

GE Finance and Insurance Limited (GE Finance)

13. GE Finance and Insurance Limited is part of the financial services division of the General Electric Co., which is listed on the New York Stock Exchange, the Boston Stock Exchange and some non-USA stock exchanges, including the London Stock

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

Exchange. General Electric's New Zealand subsidiaries include: GE Capital (NZ) Limited; GE Capital Fleet Services New Zealand Limited; GE Commercial Finance NZ; GE Consumer Finance NZ; Wizard Financial Services; and Wizard Mortgage Corporation (New Zealand).

Pacific Retail Group (PRG)

14. The Pacific Retail Group is a New Zealand Stock Exchange listed investment company focused on the consumer sector. The Pacific Retail Finance Group (PRF) is a collection of subsidiaries of the Pacific Retail Group Limited. PRF provides financial products including term sales finance to consumers via retailers, personal loans, consumer credit insurance, and retail debenture investments. PRF has a ten year merchant finance arrangement with the Noel Leeming Group, established in 2004, when PRG sold Noel Leeming to a vehicle of Gresham Private Equity.

OTHER RELEVANT PARTIES

Fisher and Paykel Finance Limited (F&P)

15. Fisher & Paykel Finance Limited is a member of Fisher & Paykel Appliances Holdings. Fisher & Paykel Finance is primarily involved in providing specialist financial services to Fisher & Paykel merchants and other retailers. In 2003 the Fisher & Paykel Finance Group acquired the Farmers Trading Company's finance and insurance businesses, including the Farmers Card. Fisher and Paykel finance products include: term sales, Farmers Card, Q Card (revolving credit), equipment finance, consumer insurance and personal loans.

FAI Finance Limited (FAI)

16. FAI Finance provides personal loans and merchant finance services. In February 2002, it was purchased by the Hanover Group. The Hanover Group's core business is property finance related transactions. Its member companies provide services in:

    - investments;
    - finance and leasing;
    - investment banking;
    - asset management; and
    - managed funds.

Five Star Consumer Finance Limited (Five Star)

17. Five Star Finance provides merchant finance and is the term sales finance preferred supplier to the New Zealand Retailers Association members. It is part of a privately owned group of companies which constitutes the Five Star Group.

New Zealand Retailers Association Incorporated (NZ Retailers)

18. The New Zealand Retailers Association is a trade association that represents around 65% of retail industry turnover. The association has approximately 5,000 members.

Harvey Norman Holdings Limited

19. Harvey Norman Holdings Ltd grants franchises to independent business operators to run Harvey Norman retail stores. Its primary business is retail home and office products. Harvey Norman is a public company listed on the Australian Stock Exchange. It has been operating in New Zealand since 1997.

Yes Finance Limited

20. Yes Finance is a privately owned finance company located in Auckland. It provides personal loans, automotive loans and some term sales.

Geneva Finance Limited

21. Geneva Finance provides personal loans, automotive loans, merchant finance and mortgage lending. It is a nationwide firm, with 18 branches.

The Warehouse Financial Services Limited

22. The Warehouse Financial Services is a joint venture between The Warehouse Limited and Westpac Banking Corporation. Its primary business is the provision of The Warehouse MasterCard. The Warehouse MasterCard is a credit card, run through Westpac Banking and marketed through The Warehouse.

PREVIOUS DECISIONS

23. The Commission previously considered the consumer finance sector in *Decision 461* (*GE Capital Finance Australasia Pty Ltd/Australian Guarantee Corp (NZ) Ltd*, 24 April 2002). In this decision the Commission considered the following markets related to the financial sector:

    - the market in New Zealand for the supply of consumer finance products (not including motor vehicles);
    - the market in New Zealand for retail merchant finance (in the alternative to the above); and
    - the market in New Zealand for the supply of business finance products.

24. The Commission considered that existing competition alleviated any concerns of unilateral power being exercised by the merged entity and that the scope for co-ordinated market power would not be enhanced by the acquisition.

INDUSTRY BACKGROUND

25. The New Zealand financial system incorporates a wide range of financial institutions, including:

    - registered banks;
    - finance companies;
    - building societies and the PSIS;
    - credit unions and friendly societies;
    - managed funds;
    - superannuation schemes; and
    - life insurance companies.[5]

26. Finance companies are non-bank financial institutions. Their main business is to lend money to small to medium sized businesses and to individuals. Finance companies can be loosely categorised into:

[5] Geoff Mortlock, Reserve Bank of New Zealand: *Bulletin Vol. 66 No. 4.*

- consumer finance;
- automotive finance;
- business finance; and
- insurance.

27. Consumer finance is provided for mainly personal, domestic or household purposes.[6] Consumer credit types available include:
    - term sales (personal loans with security against purchase);
    - store cards (for instance the Farmers card);
    - personal loans;
    - revolving credit (for instance overdraft facilities);
    - credit cards (for instance Visa); and
    - mortgages (including revolving and top-ups).[7]

Table 1: Consumer Finance Products[8]

Product	**Interest rate**	**Interest free period?**	**Security required**	**Distribution**	**Flexible draw-down?**	**Other**
Term sales	17 to 24%	Yes	Yes	Retailers	No	
Store cards	12 to 24%	Yes	No	Retailers, finance companies	Yes	To be used at participating retailers; cash advance facility
Personal loans	12 to 27%	No	Yes	Banks, finance companies, credit unions, building societies	No	
Revolving credit	12 to 24%	Yes	No	Banks, finance companies, credit unions, building societies	Yes	
Credit card	12.9 to 24%	Yes	No	Banks (either branch or website)	Yes	Loyalty programmes; cash advance facility
Mortgages	8 to 18%	No	Yes	Banks, finance companies, credit unions, building societies	Yes	Need house or other security

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[6] See www.consumeraffairs.govt.nz for information on consumer finance, including the Credit Contracts and Consumer Finance Act 2003.

[7] The Retirement Commission's advice is available on www.sorted.org.nz and the Consumer Institute's advice published on www.consumer.org.nz and is periodically updated in its magazine, *Consumer*.

[8] Information drawn from a variety of sources including: the Application, pg. 9; www.interest.co.nz; www.consumer.org.nz; and from industry participants.

28. FAI informed the Commission that the market is divided into three "tiers" of finance companies. GE Finance, PRF and F&P are the first tier. They all have high capacity and all compete for large retail customers. The second tier is made up of companies that are competitors in the merchant finance market but that would have to expand in order to provide consumer finance to larger retailers. According to FAI this category contains: itself, Geneva Finance, Gilrose Finance, Five Star and Finance Now. The third tier is made up of companies that are predominantly in the personal loans business and have some merchant finance clients, for instance Yes Finance. Smiths City and Harvey Norman currently only provide in-house finance for their own retail customers and therefore do not compete for retailers per se.

29. The consumer finance industry is governed by the Credit Contracts and Consumer Finance Act 2003. The Act aims to provide transparency in dealings between finance companies and debtors, by such means as requiring that finance companies must disclose any fees and the interest rates to consumers.

MARKET DEFINITION

30. The Act defines a market as:[9]

> … a market in New Zealand for goods or services as well as other goods or services that as a matter of fact and commercial common sense, are substitutable for them.

31. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of a market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

32. 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.

Product Dimension

33. The greater the extent to which one good or service is substitutable for another, on either the demand side or supply side, the greater the likelihood that they are bought and supplied in the same market.

34. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

[9] s 3(1) of the Commerce Act 1986.

35. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

36. The Applicant submitted that the relevant product market is consumer finance, which includes point of sale finance (merchant finance); personal loans; credit cards; revolving credit and mortgage facilities. The proposed merger would result in aggregation in the merchant finance and personal loans products. The Applicant submitted that merchant finance and personal loans both fall into the wider consumer finance market.

37. In Decision 461, the Commission considered the relevant product markets to be the markets for:

- consumer finance products; and
- retail merchant finance.

Supply-side

38. Retail merchant finance is supplied by non-bank finance institutions or finance companies including: FAI, GE Finance. PRF, F&P, Yes Finance, Gilrose, Finance Now, Five Star and Geneva.

39. Finance companies supply finance to consumers, in order for the consumers to purchase large household goods, for instance fridges or lounge suites, from retailers. Merchant finance is usually either term sales or store cards. Finance companies compete on interest cost, any commission, customer service, acceptance rate for consumer applications, size and application processing speed. Industry participants commented that customer service was the main area where competition occurs. Different finance companies also have different acceptance criteria for consumers: the higher the acceptance rate the more attractive the finance company is to the retailer.

40. Merchant finance is different from other types of finance because the transaction occurs at the time of purchase and is used specifically for that purchase. Retailers offer merchant finance at the point of sale to secure the consumer and encourage the sale to proceed.

41. To provide merchant finance, a finance company needs to have:

- a good reputation;
- good relationships with retail firms;
- sufficient funds to cover the potential business from retailers; and
- specific information technology systems to calculate the application against the finance company's criteria for lending.

42. Providers of automotive loans provide a very similar product, but the finance is available for motor vehicles instead of home and houseware products. While auto loan companies have a different set of relationships and are linked to auto dealerships, they have very similar IT systems and business roles. The same IT systems could be utilised for auto loans as for merchant finance. Auto loan finance companies could quickly and easily switch to supplying merchant finance.

43. Personal loan providers also provide similar products, but not at point of sale. Personal loan suppliers could also easily switch to offering merchant finance products if they had

a good reputation and could build a relationship with retailers. This could be done within 12 months and have relatively low costs. Most consumer finance companies provide personal loans of some kind.

44. Banks also provide personal loans. However, banks have historically steered away from high volume, low value items. Banks are also differentiated to the extent that they are unable to offer the same efficiency of service currently offered by the larger finance companies. While banks could switch to providing merchant finance, the Commission considers that a significant strategic shift would be necessary for this to occur. The Commission considers that this would be unlikely to happen quickly and a SSNIP would not be enough incentive to enter the market.

45. The Commission therefore considers that, on the basis of supply-side substitution, the market includes finance companies but excludes banks.

Demand-side

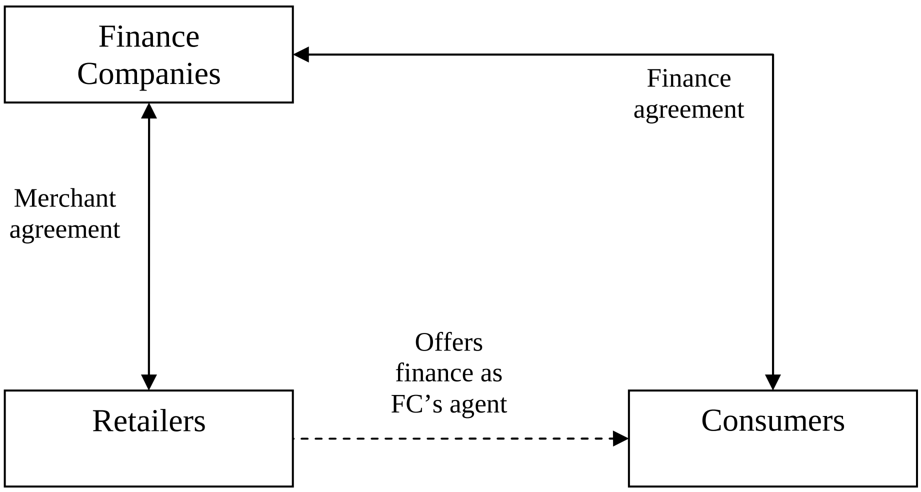
46. On the demand-side, the Commission considers there are two different types of customers:

- retailers; and
- consumers.

47. Merchant finance is finance organised in store by retailers at the point of sale. The credit contract is between the finance company and the consumer, with retailers acting as a conduit between consumers and finance companies. The retailer acts as an agent for the finance company. However, where the credit is interest free or on a deferred payment basis, the retailer pays the finance company the interest for the period. Once the sale of the goods has been concluded, the finance company pays the retailer the goods' value, less the agreed interest costs for the period.

48. Merchant finance is usually by way of term sales or store cards. In general, where the credit is interest bearing, finance companies pay the retailer a commission for providing it with each credit contract. Figure 1 demonstrates how the finance company meets the consumer via the retailer and then creates a contractual relationship with the consumer.

Figure 1: Merchant Finance Market Structure



49. Retailers and consumers could be considered either as two separate functional levels or two separate customer classes. In light of the fact that the retailers do not wholesale the financial products so much as introduce customers to the finance companies, and also of the fact that the retailers themselves receive a service from the finance companies, namely enabling retail purchases, the Commission takes the view that retailers represent a separate customer class rather than a separate functional level.

50. Retailers of large household goods buy the services of finance companies to provide in store finance. Retailers often offer consumers interest free periods and deferred payment periods, which are marketing and promotional tools. Retailers pay finance companies for the interest free and deferred payment periods.

51. Consumers contract with finance companies for finance to buy retail purchases. In addition, consumers pay finance companies fees and associated costs.

52. The relationships that finance companies have with the retailers and with the consumers are contractually separate, as are the competition dynamics. Finance companies compete to provide their service to retailers and also compete for consumers.

53. Accordingly, the Commission has separated the market by customer type:

- retailers; and
- consumers.

<u>Retailers</u>

54. As a customer, retailers informed the Commission that they want to pay the least interest possible for interest free periods and deferred payments. However, retailers also want as many consumers to be accepted by the finance company as possible and for the financing process to be fast (within a few minutes) and hassle free. These desires sometimes conflict. On balance, retailers seem to consider that finance companies' service is more important; for instance, Telecom informed the Commission that the reason it stopped using FAI was that FAI was only accepting 50% of its consumers' finance applications. GE Finance informed the Commission that Carters switched its business from GE because of [ ].

55. Retailers utilise merchant finance to enable sales. Merchant finance provides finance that is impulsive, instantaneous and occurs at the point of sale. High amounts of retailers' sales use merchant finance, for instance Harvey Norman does [ ] of its sales through finance. Retailers rely on merchant finance to capture customers making impulsive purchases. PRF stated that merchant finance helps to enable the sale – from a retailer's perspective it is a part of the sale.

56. The Applicant submitted that credit cards and other consumer finance products are substitutable for merchant finance. However, from the retailer's perspective other products are not substitutable because merchant finance picks up customers without current finance and customers who purchase on impulse while in store. Therefore, any finance product that cannot be purchased or organised at point of sale is not substitutable. No other finance product is organised or purchased in store. Accordingly, the Commission considers there to be almost no demand side substitutability for the provision of merchant finance to retailers.

<u>Consumers</u>

57. From the consumer's perspective there is a plethora of consumer finance options, including:

- credit cards;
- personal loans;
- revolving credit; or
- revolving/top up mortgage.

58. From the consumer's perspective, credit cards are very similar to store cards (one of the lending forms of merchant finance). Store cards and credit cards both have a maximum credit limit and require minimum monthly instalments, but the total is not required to be paid in full. Credit cards and store cards also have similar interest rates (credit cards: 12.9-24% and store cards 12 to 24%). The substantive difference between them is that store cards can only be used in specific stores whereas credit cards can be used in most places. However, store cards are becoming more universal. For instance, the Farmers card can be used in over 3,000 individual stores including petrol stations, pharmacies and gardening stores. The Commission considers that credit cards can substitute for merchant finance, but that merchant finance is not an ideal substitute for credit cards.

59. For the consumer, personal loans and term sales are very similar: both products have a lump sum payment, a fixed payment schedule, and are for a set period of time. Both products have a high variance in the amount of interest charged that generally depends on the characteristics of the individual consumer. The main difference is that term sales are secured loans and are applied for in store, while personal loans are only sometimes secured and are not arranged in store. In addition, the security for term sales is usually over the product being purchased, while personal loan security can be over anything. The Commission considers that while personal loans are not a perfect substitute, there is a high degree of substitution between personal loans and term sales.

60. Revolving credit can be a banking facility, like an overdraft, or a more specific credit facility. Store cards and credit cards are a specific form of revolving credit, with no minimum drawdown but a specific maximum limit and no specific payback schedule.

61. The Commission recognises that not all consumers have access to the full range of consumer finance products or providers and that there may be limited substitutes available to consumers with poor credit history or who are otherwise vulnerable. PRF

and GE do not target these customers. However, for the purposes of this decision the Commission does not consider it necessary to define a separate market for the provision of finance products to vulnerable consumers.

62. The Commission considers that mortgages are different from the other consumer finance products, due to the use of property for security. While it is acknowledged that consumers could and, according to industry participants and mortgage providers, do substitute mortgages for retail purchases, the consumer's ability to switch to a mortgage from other consumer finance products is complicated as it involves security over property and is probably not likely as a result of a small, yet significant and non-transitory 5-10% price increase. If a consumer already had a mortgage, then utilising this for major retail purchases could be accomplished relatively easily (whether by foregoing mortgage repayments or by increasing the size of the principal); however, if a consumer did not already have a mortgage, obtaining one for a major retail purchase would not be likely. The need to provide property security is also a major differentiating factor.

63. While the Commission acknowledges that there are differences in the consumer finance products discussed (other than mortgages), these differences are outweighed by the high degree of substitutability. There are differences between the products, but industry participants informed the Commission that consumers use the products interchangeably. The Commission considers that the consumer finance products (excluding mortgages) are close enough substitutes that, in the face of a SSNIP, consumers would switch between products. Therefore, the Commission considers that merchant finance for consumers is part of the wider consumer finance market.

Conclusion on Product Market

64. The Commission considers that the high demand-side substitutability for consumers for both personal loans and merchant finance means that these products are included in the consumer finance market. However, the Commission considers that the lack of demand-side substitutability for merchant finance for retailers means it is likely that the this forms a discrete market. Therefore, the Commission concludes personal loans and merchant finance form part of the consumer finance market and that merchant finance to retailers is a discrete market.

65. The relevant product markets are therefore:

- merchant finance to retailers; and
- consumer finance.

Functional Markets

66. 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. 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.

67. Finance companies provide a service to retailers to enable them to supply finance to consumers. Retailers buy interest free periods from finance companies. Consumers contract with finance companies to purchase finance.

68. For the purposes of the present application, the Commission considers the relevant functional level to be the provision by finance companies of merchant finance services to retailers and consumer finance to consumers.

Geographic Extent

69. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

70. The Applicant submitted that the relevant geographic markets are national in scope. This is consistent with previous Commission decisions.

71. Market participants informed the Commission that the relevant markets are national in scope. Consumer finance companies are able to run a national office from centralised call centres, with travelling sales staff. All administration, financing and customer service can be provided from one central location. Applications for finance are predominantly made through the internet and by fax, meaning that a retailer in Invercargill gets the same service as one in Auckland. The price for finance is the same across the country.

72. In light of this, for the purposes of the present application, the Commission considers the scope of the geographic dimension of the relevant markets to be national.

Conclusion on Market Definition

73. The Commission concludes that the relevant markets are the national markets for the provision of:

- merchant finance products to retailers (merchant finance market); and
- consumer finance products (consumer finance market).

FACTUAL AND COUNTERFACTUAL

74. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgment considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (the counterfactual).[10] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

75. The Applicant submitted that its rationale for the merger is for GE Finance to broaden its distribution and to extend its range of financial services.

76. In the relevant factual scenario, in respect of both markets, GE Finance and PRF will combine to become one entity. The combined entity would continue to operate in the relevant markets.

Counterfactual

77. PRG informed the Commission that [

]

[10] Above note 3.

78. [

]

79. The Commission considers that the likely counterfactual scenario for the purposes of this analysis is the acquisition of PRF by either a party not already participating in the merchant finance market, or one that has a significantly smaller presence than GE Finance.

COMPETITION ANALYSIS

Existing Competition

80. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product mix (near competitors). Supply side substitution by near competitors arises either from redeployment of existing capacity, or from expansion involving minimal investment, in both cases involving a delay of no more than one year.

81. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

82. The Commission identifies market shares for all significant participants in the relevant market. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities, or inputs (such as labour or capital) used.

83. An aggregation that would result in a low concentration level is unlikely to be associated with a substantial lessening of competition in a market. On this basis, indicative safe harbours may be specified.

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

    - 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 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 Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market. Specifically, the Commission seeks to understand the dynamics of the competition that would exist between the remaining firms in the market, compared to what would exist in the absence of the merger.

Consumer Finance Market

86. As the consumer finance market is broad and participating companies are numerous, estimating market shares for this market is difficult. Reserve Bank figures show that non-bank financial institutions and banks collectively have $10.6 billion dollars of personal consumer debt.[11] Post-acquisition the combined firm's consumer finance receivables products would be [ ]. This would be approximately a [ ]% market share. Table 2 shows the relative percentages of the total consumer finance market.

Table 2: Consumer Finance Market Shares

Firm	**Net receivables ($000,000)**	**Market Share**
GE	$[ ]	[ ]%
PRF	$[ ]	[ ]%
Combined Firm	$[ ]	[ ]%
Reserve Bank market estimate	$10,060	100%

87. In comparison to the market as a whole, the acquisition would result in two small players combining. In the counterfactual, GE's market share would be [ ]% and in the factual it would be [ ]%. Given the combined firm's size post-acquisition relative to the market, the Commission is of the view that the difference between the factual and counterfactual would not be significant. Accordingly, the Commission considers that the proposed acquisition would be unlikely to result in a substantial lessening of competition in the consumer finance market.

Merchant Finance for Retailers Market

88. The existing competitors in the merchant finance market are GE Finance, PRF, F&P, FAI, Geneva Finance, Gilrose Finance, Five Star, Smiths City, Harvey Norman and Finance Now. Table 3 shows the merchant finance market estimated market shares in the year to December 2005.

[11] Reserve Bank of New Zealand, Money Credit and Financial Statistics, C6 Non-Banking Financial Institutions, total household claims, November 2005.

Table 3: Merchant Finance for Retailers Market Share Figures by net receivables

Firm	**Net receivables ($000,000)**	**Market Share**
GE	*$[ ]*	*[ ]%*
PRF	*$[ ]*	*[ ]%*
Combined Firm	$[ ]	[ ]%
F&P	$[ ]	[ ]%
Five Star	$[ ]	[ ]%
Finance Now	$[ ]	[ ]%
Gilrose	$[ ]	[ ]%
FAI	$[ ]	[ ]%
Total	[ ]	100%

89. Post acquisition, in the merchant finance market, the combined entity would have a market share of [ ]% and the three firm concentration ratio would be [ ]%. This is outside the Commission's safe harbours.

90. F&P owns both the Farmers Card and also the revolving credit Q Card. F&P stated that it goes "head to head" with GE Finance. Further it stated that GE Finance is [ ]. The Commission considers F&P and GE Finance compete robustly. GE Finance is currently targeting its competitors' merchant finance customers, [ ], while F&P is focussing on building up their Q card and [ ].

91. Presently, the competition from individual smaller players is not significant. The smaller second tier merchant finance companies lack the capacity to take on large jobs. For instance, Harvey Norman informed the Commission that [ ]. The larger finance companies also have a significant amount of brand awareness, especially through their store cards (the Q Card, the Farmers card and Creditline card). Presently, the smaller companies provide a limited constraint on the larger companies.

92. The Applicant submitted that merchant finance companies are able to expand quickly. It cited F&P's and PRF's growth over the last few years. PRF was formed to acquire Noel Leeming and Bond and Bond's finance books but has grown substantially in the market [ ]. Further, by building up a solid base of merchant finance customers, PRF has been able to expand quickly and easily into the personal loans market. Evidence from other market participants shows that PRF's success may not be consistent with the rest of the market. Several firms, including [ ], have struggled financially after mishandling and losing large clients. Also, PRF's growth has occurred mostly in the personal loans side of its business, rather than merchant finance. The Commission notes that expansion in this market has traditionally been through acquisition — for instance, GE Finance acquiring AGC and F&P acquiring the Farmers cards — and not through organic growth.

93. The Commission considers that barriers to expansion are moderate and include:

- access to more funds;
- building of reputation and relationships with retailers;
- acquisition of larger IT systems; and
- capacity.

94. The Commission considers, that in the factual scenario, existing competition would constrain the combined entity only to a degree, due to the combining of the two of the three largest competitors. While in the counterfactual the degree of constraint would be significantly higher because of continued competition between PRF, GE Finance and F&P. Accordingly, it is necessary to consider whether countervailing power would be sufficient to constrain the combined firm in the factual scenario.

<u>Countervailing Power of Buyers</u>

95. In some circumstances the potential for the combined entity to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition.

96. The Commission investigated the extent to which the retailers would provide a constraint on the combined entity, post acquisition.

97. Market participants informed the Commission that retailers can exercise countervailing power by:
    - their size in relation to the finance companies;
    - switching finance providers;
    - self supply; and
    - not offering interest free deals.

98. The retailers make up a large proportion of the merchant finance companies' books. For instance, Harvey Norman is equivalent to [ ]% of GE Finance's total merchant finance business. In addition, almost all of [ ] merchant finance business comes through [ ]. Large retailers make up a significant proportion of large merchant finance firms' businesses – to lose a big client would have significant impact. Retailers, for instance Harvey Norman, are aware of this imbalance and are in a strong negotiating position because of it.

99. Industry participants informed the Commission that most retailers do not have a fixed contract with finance companies to be the sole merchant finance provider. Industry participants informed the Commission that they will generally use a regular finance company and then, for a special promotion, will negotiate a special rate with a different finance company. Industry participants also informed the Commission that retailers will change providers if they are dissatisfied with any aspect of the provider's performance. GE Finance cited that it lost the Carters Building Supplies business due to [ ]. Similarly, Telecom was using FAI for mobile phone financing [ ]. Accordingly, Telecom asked for tenders from other finance companies and then switched providers to PRF.

100. Finance company industry participants also informed the Commission that a retailer may go through different finance companies for a consumer. For instance, the consumer may not qualify for a GE Finance creditline card due to their living situation but would qualify for term sales from a second tier firm, like FAI. Retailers often have relationships with more than one finance company to enable this.

101. The Commission considers that retailers' ability to quickly switch suppliers and the lack of contractual ties means that the retailers are able to exert influence on the price of finance they pay.

102. Retailers also have the ability to either start or expand current finance self supply. Traditionally large retailers ran their own in store finance systems, for instance Smiths City and Farmers. The Farmers card was only separated from the Farmers stores and sold to F&P in 2003. Smiths City still runs its own finance book. Harvey Norman recently started an in-house financial service to provide its customers with term sales. Harvey Norman informed the Commission that the merchant finance companies [ ]. It informed the Commission that [ ]. GE Finance also stated that [ ]. Telecom also runs its own in-house finance for customers with a Telecom land line, [ ] informed the Commission that it [ ].

103. While the Commission acknowledges that currently no major retailer except Smith City itself provides finance to customers, the Commission considers that the ability of retailers to enter quickly or to expand in-house finance has a substantial influence on the behaviour of finance companies. Retailers need the following to expand or enter the merchant finance market:

- access to funds;
- specialised financial IT systems; and
- staff.

104. Merchant finance companies are aware and several acknowledged this to the Commission. The Commission considers that the competitive constraint is not the actual occurrence of retailers using in-house finance, but the unspoken threat that retailers could and would if they chose to.

105. The New Zealand Retailers Association informed the Commission that retailers use interest free periods as promotion and marketing tools. Retailers are able to stop using finance as a marketing tool and have it simply as a sale enabler. Some retailers already act in this way; for instance, The Warehouse does not offer interest free deals on its term sales. Retailers could simply stop offering interest free periods as special marketing promotions and the finance would no longer be a cost to them. Without this incentive for customers to use finance, the amount of merchant finance sales is likely to fall. If the retailers do not offer interest free or deferred payments, then consumers are more likely to choose other consumer finance options, for instance, credit cards, instead of merchant finance.

106. PRF stated that finance companies view merchant finance as a cheap source of origination of customers and that the retailers are a valuable channel. This would negatively impact on the finance companies.

107. Currently, the market dynamic enables a win/win situation. The retailers are satisfied because they are able to enable customers to purchase goods with finance at point of sale and the finance companies are satisfied because in store finance is a significant "channel to market" to obtain new customers (to whom they can offer other finance products). The Commission considers the retailers' ability to do this, and the loss the finance companies would face, means that retailers are able to influence the finance companies to a significant extent.

108. The Commission considers that, given large retailers' and retail associations' ability to switch finance providers, to self supply and to eliminate the interest free periods, that the retailers exercise considerable influence on the finance companies. Accordingly, the Commission considers that the retailers have sufficient ability to constrain market participants to such an extent that competition would not be substantially lessened by the acquisition.

Conclusion on the Merchant Finance Market

109. The Commission concludes that in the merchant finance market the combined entity would be constrained by the countervailing power of large retailers and to a lesser degree by existing competition.

OVERALL CONCLUSION

110. The Commission is therefore satisfied that the proposed acquisition would not have, nor be likely to have, the effect of substantially lessening competition in the national markets for the provision of:

- consumer finance (including personal loans and merchant finance); and
- merchant finance for retailers.

DETERMINATION ON NOTICE OF CLEARANCE

Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for GE Finance Limited to acquire the business and assets of the Pacific Retail Finance Group: Pacific Retail Services Limited; Pacific Retail Finance Limited Montreal Financial Services Limited and a 100% shareholding in Simply Insurance New Zealand Limited.

Dated this 18 January 2006

Paula Rebstock
Chair
Commerce Commission