

## COMMERCE COMMISSION

### Decision No. 630

Determination pursuant to the Commerce Act 1986 in the matter of an application for Proposal

**A&R WHITCOULLS HOLDINGS GROUP PTY LIMITED**

and

**BORDERS NEW ZEALAND LIMITED**

- The Commission:** Paula Rebstock  
Donal Curtin  
Gowan Pickering
- Summary of Application:** The acquisition of 100 % of the shares in Borders New Zealand Limited by A&R Whitcoulls Holdings Group Pty Limited, or an interconnected body corporate of A & R Whitcoulls Holdings Group Pty Limited.
- Determination:** Pursuant to Section 66 (3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition
- Date of Determination:** 20 November 2007

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**EXECUTIVE SUMMARY**

- E1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 24 September 2007. The notice sought clearance for the acquisition of 100 % of the shares in Borders New Zealand Limited (Borders) by A&R Whitcoulls Holdings Group Pty Limited (ARW), or an interconnected body corporate of ARW.
- E2. The proposed acquisition involves overlap in the retailing of books, stationery and DVDs. Retailers of stationery and DVDs are numerous and fragmented, and any aggregation in respect of stationery and DVDs is likely therefore to be *de minimis*. For this reason, in this particular fact scenario the Commission has not considered the impact on the retailing of stationery and DVDs.
- E3. Book retailers differ in terms of their product and service offerings. Some book retailers, such as The Warehouse and Kmart, have a narrower title range and primarily compete on price. Other book retailers, such as Dymocks and Unity, stock a wide range of titles and compete on both price and non-pricing attributes. However, the Commission considers that the degree of differentiation between book retailers does not warrant separating them into discrete markets.
- E4. For the purpose of assessing this fact scenario, the Commission has excluded internet book retailers from the book retail market; however, it considers that for some consumers, online retailers are an adequate substitute for bricks-and-mortar retailers, and duly takes this into account in the competition analysis. The Commission also acknowledges that in other fact scenarios, it may be desirable to review this definition of the book retail market.
- E5. To this end, the Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition in the markets for:
- the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts (*the book retail markets*); and
  - the publishing and supply of books to retailers in New Zealand (*the book publishing market*).
- E6. The Commission considers the factual scenario to be that ARW will own and operate Borders in New Zealand. Although ARW has stated that it intends to continue to operate Borders store under the Borders banner, which will be subject to the Borders Licence Deed, the Commission is of the view that ARW will be in a position to change this strategy should it wish to do so.
- E7. The sale of Borders is a bidding process, and so the Commission considers that the most likely counterfactual scenario is that Borders will be acquired by a third party that would not give rise to a substantial lessening of competition in any market.
- E8. In respect of the Auckland CBD market, the Commission considers that post-acquisition the combined entity is likely to face some price competition from Dymocks. The Commission is of the view that the combined entity will continue to face constraint in terms of non-pricing attributes from Unity,

Dymocks, and UBS, and to a lesser extent, niche bookshops such as Real Groovy due to their fragmented nature and limited subject range.

- E9. In the Wellington CBD market, the Commission considers that Dymocks, and to a lesser extent Paper Plus, are likely to continue to compete with the combined entity on price post-acquisition. In respect of non-pricing attributes, the Commission is of the view that the combined entity will continue to face constraint from Unity and Dymocks, and to a lesser extent, other small bookshops such as Parsons, Paper Plus and niche bookshops, due to their fragmented nature.
- E10. The Albany and Riccarton shopping precincts have a similar market structure, whereby there are three remaining competitors to the combined entity in the factual. The Commission considers that in these two markets, the combined entity is likely to face pricing competition from each of The Warehouse and Paper Plus, and to a lesser extent, Kmart. Paper Plus is also likely to provide some competition on non-pricing attributes. Other than Borders, there is presently no book retailer in the Albany or Riccarton shopping precincts that primarily competes on non-pricing attributes and this is unlikely to change post-acquisition.
- E11. The Commission is of the view that existing book retailers could expand and provide additional constraint on the combined entity by sourcing more books through existing supplier relationships and securing larger retail space. The Commission notes that retailers which currently provide a narrow title range are able to expand their title range should market circumstances change.
- E12. Regarding constraint from potential competition, the Commission is of the view that anyone seeking to enter the relevant book retail markets is unlikely to face high barriers. New entry is most likely to occur by a book retailer with an existing network of stores in New Zealand, and entry by such a player is likely to constrain existing players in these markets post-acquisition. Furthermore, once established in a market, a retailer would not face significant barriers to expansion, as it could source additional stock through existing supplier relationships. The Commission considers new entry is feasible within a two-year timeframe.
- E13. Although the Commission has excluded internet book retailers from the relevant markets, it acknowledges that these retailers do provide some degree of competition for book sales with bricks-and-mortar retailers. In addition, internet book retailers do not face the same expansion requirements as bricks-and-mortar retailers, and can therefore expand even more easily than bricks-and-mortar retailers. For these reasons, the Commission considers that internet book retailers are likely to provide some degree of constraint in the factual scenario.
- E14. Whilst the proposed acquisition does not result in any aggregation in respect of the upstream publishing/supply market, the Commission has examined whether the proposed acquisition would result in the combined entity gaining market power as a purchaser in this market. The Commission considers there is clearly an interdependent relationship between publishers and retailers, and this would remain the case post-acquisition. Although ARW would become a larger retailer, the Commission does not consider that it would have undue market power in the retail market. Accordingly, any increased strength it may

have as a buyer is not likely to significantly affect the current level of competition in the upstream supply market.

- E15. The Commission is therefore satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any market.

## THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 24 September 2007. The notice sought clearance for the acquisition of 100 % of the shares in Borders New Zealand Limited (Borders) by A&R Whitcoulls Holdings Group Pty Limited (ARW), or an interconnected body corporate of ARW.

## PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 21 November 2007.
3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.<sup>1</sup>

## STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal has, or is likely to have, the effect of substantially lessening competition in the 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 satisfied it must decline the application. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.<sup>2</sup>
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;
 

“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 judgement 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 would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.”<sup>3</sup>
7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is

<sup>1</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

<sup>2</sup> *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

<sup>3</sup> *Air New Zealand & Qantas Airways Limited v Commerce Commission* (2004) 11, TCLR 347, Para 42.

more nominal and not minimal.<sup>4</sup> 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.

8. 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 ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.
9. 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**

10. 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).
11. 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, in terms of:
  - existing competition;
  - potential competition; and
  - other competition factors, such as the countervailing market power of buyers or suppliers.

### **THE PARTIES**

#### **A&R Whitcoulls Holdings Group Pty Limited (ARW)**

12. ARW is an Australian proprietary company registered with the Australian Securities and Investments Commission, and is owned by Pacific Equity Partners Pty Limited. In New Zealand, ARW is involved in the retail of books, magazines, stationery, cards and DVDs through its wholly-owned subsidiary Whitcoulls Holdings Limited. ARW has 84 stores throughout New Zealand,

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

operating under the Whitcoulls and Bennetts banners, and retails books through its website [www.whitcoulls.co.nz](http://www.whitcoulls.co.nz).

### **Borders New Zealand Limited (Borders)**

13. Borders is a wholly-owned subsidiary of Borders Group Inc., which is in turn listed on the New York stock exchange. In New Zealand, Borders is involved in the retail of books, magazines, stationery, cards, DVDs and CDs. It has stores located in Auckland CBD, Newmarket, Wellington CBD and Riccarton, with a fifth store due to open in Albany in November 2007. Borders New Zealand does not presently offer an online service in New Zealand.

### **OTHER PARTIES**

14. A complete list of other parties that provided information and submissions to the Commission is included in Appendix 1.

#### *Dymocks Franchise Systems (NZ) Limited (Dymocks)*

15. Dymocks is a specialist book retailer, with stores throughout Australia, New Zealand and Hong Kong. At the time of this Decision, Dymocks had five stores in New Zealand (Auckland CBD, Newmarket, Napier, Wellington CBD, and Lower Hutt), with plans to open stores in Hamilton and Tauranga by the end of 2007. The Auckland CBD store is a joint venture between Dymocks Group and a franchisee, and the other stores throughout New Zealand are franchised.

#### *Paper Plus New Zealand Limited (Paper Plus)*

16. Paper Plus is a cooperative franchise group, comprising 170 Paper Plus, Take Note, and Office Spot stores throughout New Zealand. Paper Plus sells a range of products similar to those sold in Whitcoulls stores: books, stationery, games, and giftware.

#### *Unity Books (Auckland) Limited and Unity Books (Wellington) Limited (Unity)*

17. Unity is an independently-owned book retailer with stores in Auckland CBD and Wellington CBD. It is a specialist bookshop and offers a wide range of titles.

### **INDUSTRY BACKGROUND**

18. The key participants in the book industry are authors, publishers, wholesalers, retailers, and customers.

#### **Publishing/Supply of Books**

19. Publishers hold copyright licences on behalf of authors for the majority of the books they publish, set recommended retail price, and negotiate promotional terms with retailers. Books published by large publishing houses account for the majority of all books published in New Zealand.<sup>5</sup>
20. In New Zealand, publishers supply books directly to retailers. Retailers also parallel import books acquired from wholesalers based in the UK (e.g., Gardners Books Limited) or the US (e.g., Baker & Taylor).<sup>6</sup>

<sup>5</sup> BPANZ, *Survey of Book Publishing in New Zealand*, December 2006.

<sup>6</sup> Wholesalers have a non-exclusive relationship with overseas publishers and on-sell books to retailers.



21. Retailers usually purchase books from publishers on a sale-and-return basis: retailers pay for the books they stock, and unsold books are returned to the publisher for a credit. On some occasions, retailers buy books on a firm basis, meaning they cannot be returned to the publisher.
22. The commercial terms offered by publishers to retailers are typically expressed as a discount off recommended retail price. Retailers and wholesalers negotiation both standard discounts and promotional discounts with publishers, on an annual or bi-annual basis. Standard discounts apply to the whole of a publisher's title range, whilst additional promotional discounts are negotiated for specific titles.
23. For the most part, the level of discount reflects the volume of books purchased, although distribution costs and whether the books are sold on a sale-and-return basis or firm basis are also relevant. For example, Random House advised the Commission that  
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### **Book Retailing**

24. The majority of book retailers sell a range of genres of books, such as sport, cooking, children's books, and fiction.
25. Front-list titles are typically new releases and best sellers, such as the Harry Potter series and Dan Brown's The Da Vinci Code. Back-list titles are those which fall outside of the front-list category. In general, competition for front-list sales occurs on price, and often the most popular of these books are priced as loss leaders. Conversely, back-list titles usually sell at recommended retail price and book retailers usually compete for back-list sales on title range and value-added services, such as customer service, book signings, and providing a pleasant shopping environment.
26. In general, book retailers fall into one of the below listed categories - although it should be noted that these should not be thought of as discrete categories, but as points on a continuum:
  - Department Stores. Department stores sell a wide range of products, and their book offering is generally limited to front-list titles and popular back-list titles. These book retailers primarily compete on price. Examples include The Warehouse and Kmart;
  - Generalist Bookshops. These bookshops sell a range of products including books, stationery, and giftware. They are primarily focused on selling front-list titles, and a range of back-list titles which are comparatively narrower than offered by specialist bookshops. These book retailers compete on price, and to a lesser extent, non-pricing attributes such as title range and service. Examples include Whitcoulls and Paper Plus;
  - Specialist Bookshops. The majority of product offered in-store is books, and these bookstores offer front-list titles and a wide range of back-list titles. These book retailers primarily compete on non-pricing attributes, and some specialist bookshops also engage in price-competition. Chain-store examples include Borders and Dymocks, independently-owned examples include Unity and Parsons; and

- Niche Bookshops. Niche bookshops offer titles related to a specific genre, and mostly compete in terms of non-pricing attributes. Examples include Real Groovy (music and popular culture), and Bennetts and UBS (educational textbooks and technical books).

## PREVIOUS COMMISSION DECISIONS

### Commerce Commission

27. The most recent Decision relating to book retailing is *Rank Group Limited / Whitcoulls Group Limited*, 22 August 1991. In that Decision, the Commission considered the markets for the retailing of general books and magazines, the retailing of educational texts, the wholesaling of educational texts, the retailing of retail stationery and commercial stationery, and the wholesaling of school stationery. The Commission determined that the proposed acquisition would not result, or would not be likely to result in any person acquiring or strengthening a dominant position in any market<sup>7</sup>, as “the markets contain a large number of competitors and entry conditions are not onerous”.

### Other Jurisdictions

28. In *HMV Group plc and Ottakar's plc*, 2006, the UK Competition Commission (UKCC) considered the relevant market to be the market for the retail sale of new books (best-sellers or deep-range titles)<sup>8</sup> at both a local/regional level and national level in the UK.<sup>9</sup> The UKCC considered that the retail market included bricks-and-mortar retailers, supermarkets, and distance sellers (including internet retailers such as Amazon.com).
29. In its Decision, the UKCC also considered whether the combined entity would have enhanced buyer-power that might in turn incentivise publishers to increase the recommended retail prices or reducing discounts offered to other book retailers (most likely independents).
30. The UKCC concluded that there was unlikely to be enhanced scope for vertical effects post-acquisition, as the publishers' ability to increase recommended retail prices was unlikely to change as a result of the proposed merger. That is to say, if it was in the publishers' interest to reduce discounts to independents, they would have done so already. In any case, the UKCC considered the competitive constraint from independents to be not very strong, and any reduction in discounts provided to independents would be unlikely to result in a substantial lessening of competition.
31. The UKCC also considered the incentives on publishers to publish or promote new titles, or authors to write new books, and concluded that these incentives were unlikely to change as a result of the proposed merger, as publishers have

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<sup>7</sup> It is noted that at the time of the *Rank / Whitcoulls* case, the “acquisition or strengthening of dominance” threshold applied, whereas the current threshold in the Act is “substantial lessening of competition”

<sup>8</sup> Whilst the UKCC considered the relevant product market to be the retail sale of new books to consumers, it was appropriate to assess separately the competitive effects of the proposed merger in terms of sales of deep-range titles and best-sellers.

<sup>9</sup> The UKCC considered it appropriate to assess the competition implications in respect of a national market because major retailers (including the Acquirer and Target) have nationwide coverage and primarily uniform pricing nationwide. Similarly, it considered it appropriate to also assess the competition effects on a local/regional basis as there may be some local variation in service quality.

alternative ways of promoting books, and any titles not promoted by the merged entity could still be promoted by other retailers or by other methods.

32. The UKCC concluded that “the proposed acquisition of Ottakar’s by HMV ... may not be expected to result in a {substantial lessening of competition}<sup>10</sup> in the market for the retail sale of new books (best-sellers or deep-range titles) at a local, regional or national level in the UK”, as the combined entity would continue to face constraint from existing competitors, such as bricks-and-mortar retailers, supermarkets, and distance sellers.

## MARKET DEFINITION

33. 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.”<sup>11</sup>

34. 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 the 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.

35. The Commission has stated in its Mergers and Acquisitions Guidelines:

“For competition purposes, a market is defined to include all those suppliers and all those buyers, between whom there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce or who could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition.”<sup>12</sup>

36. The Applicant submitted the relevant markets are:

- the national retail market for fiction and non-fiction books (hard and soft cover);
- the national retail market for the supply of DVDs; and
- the national retail market for the supply of stationery supplies.

## Product and Functional Dimensions

37. The proposed acquisition involves aggregation in respect of the retail of stationery, books and DVDs. The Applicant submitted that the retail of stationery, books and DVDs comprise discrete markets. This view was shared by industry participants interviewed by the Commission.

<sup>10</sup> The UKCC considered that, in the short term, the proposed merger was unlikely to result in a substantial lessening of competition in relation to range (of book titles), and in the longer term, store closures would be unlikely to lead to a substantial lessening of competition.

<sup>11</sup> Section 3(1) of the Commerce Act 1986.

<sup>12</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

38. Industry participants advised the Commission that there are a large number of players in the stationery and DVD markets, and that any aggregation resulting from the proposed acquisition is likely to be *de minimis*. Therefore, for the purposes of this particular fact scenario, the Commission does not intend to further consider the markets for stationery and DVDs in this Decision.

### *Book Retailing*

#### Retailers of New Books and Retailers of Second-Hand Books

39. In *HMV Group plc and Ottakar's plc*, the UKCC considered that the relevant market excluded second-hand books or books borrowed from public libraries, as the UKCC saw no evidence that small changes in the price of new books caused consumers to substitute purchases of second-hand books or book borrowing from public libraries for purchases of new books.<sup>13</sup>
40. The Commission has considered whether, in the New Zealand context, second-hand bookshops may fall within the same market as retailers of new books. The Commission is of the view that there will be some consumers who may consider a second-hand book as a substitute for a new book. In addition, retailers of second-hand books may find it reasonably straight-forward to switch to selling new books, should they have sufficient incentive. That is to say that there is some substitutability on both the supply- and demand-sides. However, the Commission does not consider this degree of substitutability to be sufficient to warrant placing them within a single product market. Its view in this respect is consistent with that of the UKCC in *HMV Group plc and Ottakar's plc*.

#### Internet Book Retailers and Bricks-and-Mortar Book Retailers

41. The Applicant submitted that market participants include established book chains (e.g., Paper Plus and Dymocks) discount department stores (e.g., The Warehouse and Kmart), independents (e.g., Unity, Parsons and Real Groovy) – all of which are bricks-and-mortar book retailers – as well as internet/online retailers (e.g. The Nile and Amazon.com).
42. In *HMV Group plc and Ottakar's plc*, the UKCC concluded that the relevant market included internet book retailers, due to the extent of price competition between bricks-and-mortar retailers and internet retailers on best-sellers.<sup>14</sup>
43. Online retailers provide customers with a visual interface that displays the title range available. Customers select their book(s) and make a purchase using remote payment methods. The purchase triggers an order request that is relayed directly to a publisher or wholesaler, which distributes book orders to the retailer on a weekly or twice-weekly basis. The retailer then distributes the book to the customer. The time taken between placing an order and receipt of the book can vary from one to three weeks.
44. Because online retailers do not hold stock, they are not limited by physical space and can offer their customers any of the two million titles currently in print. Online retailers provide additional value-added services such as online reviews and clustering.<sup>15</sup>

<sup>13</sup> UKCC, *HMV Group plc through Waterstone's Booksellers Limited / Ottakar's plc*, 12 May 2006, p 15.

<sup>14</sup> UKCC, *HMV Group plc through Waterstone's Booksellers Limited / Ottakar's plc*, 12 May 2006, p 15.

<sup>15</sup> Clustering is a function which shows other books purchased by customers who purchased a specific title.

45. Bricks-and-mortar retailers hold books in stock and offer an interactive shopping experience - customers can peruse titles before purchasing their selected book to take home with them. As bricks-and-mortar retailers hold stock, they are constrained by physical space and therefore limit the range of titles on offer, for example, smaller Whitcoulls stores hold 10-15,000 titles, and larger Whitcoulls stores hold up to 25-30,000 titles. Bricks-and-mortar retailers provide additional value-added services such as face-to-face advice and the opportunity to attend book signings and meet authors.
46. The Applicant suggested that internet sales account for around 5 % of all book sales in New Zealand. The view of the majority of industry participants was that, whilst there is little accurate information available on internet book sales in New Zealand, the Applicant's estimate of 5 % is likely to be correct – noting that the market share of internet retailers in New Zealand is well below that in many overseas countries.<sup>16</sup> The publishing company Hachette Livre suggested that this could be explained by the comparatively high cost of fast delivery from overseas, and it noted that a high proportion of books purchased by way of the internet were technical books not stocked by New Zealand retailers.
47. Book retailers canvassed by the Commission had mixed views as to the extent of competition between online retailers and bricks-and-mortar retailers. For the most part, bricks-and-mortar retailers, such as Unity and Dymocks, considered their greatest competitors to be other bricks-and-mortar retailers, viewing online sales as comprising only a small proportion of all book sales in New Zealand. The Nile, an online book retailer, considers its greatest competitors to be online retailers Amazon.com and Fishpond.co.nz, as well as bricks-and-mortar retailer ARW.
48. Whilst there are clear differences in the shopping experiences offered by online retailers and bricks-and-mortar retailers, industry participants commented that free-riding between internet book retailers and bricks-and-mortar book retailers is common: a customer might research reviews on Amazon.com, but then purchase a book from their local bookshop. Similarly, a customer might browse titles at their local bookshop but choose to purchase their book from an online retailer. [ ], for example, advised the Commission that it uses Amazon.com to research book reviews in order to make recommendations to customers that visit its bricks-and-mortar bookshops.
49. The Commission considers it is likely that for some consumers, on-line retailers are an adequate substitute for bricks-and-mortar retailers. At this stage, however, the relatively small percentage of books purchased in New Zealand from on-line retailers suggests these consumers may not yet be sufficiently large in number for on-line retailers to, by themselves, constrain prices charged by bricks-and-mortar retailers. The Commission notes that this situation may change in the future as online purchasing becomes more popular.<sup>17</sup>
50. For the purpose of assessing the current Application, the Commission has considered that on-line book retailers do not fall within the relevant market. The Commission recognises that on-line retailing may have some competitive influence on the market, and to this extent, factors this influence into its

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<sup>16</sup> For example, in *HMV Group and Ottakar's*, the UKCC estimated that internet retailers account for 8 % share of national book sales in 2005.

<sup>17</sup> Both Real Groovy and The Nile advised the Commission that on-line book sales have increased over the last few years, and are expected to continue to increase in the future.

competition analysis. The Commission notes that in other fact circumstances it may be desirable to revisit this market definition.

### The Retailing of Books

51. As discussed in paragraph 26, book retailers vary in terms of the range of genres of books they sell,<sup>18</sup> and the proportional mix of front-list and back-list titles.<sup>19</sup> Book retailers can also differ from one another in terms of service offerings.<sup>20</sup>
52. A customer who wants to purchase a front-list title or a popular back-list title could choose between a department store, generalist bookshop or specialist bookshop, and to a more limited extent, a niche bookshop, whereas a customer who wants to purchase a back-list title, or a title relating to a specific genre, may have fewer choices of retailer to choose from.
53. On the supply-side, bookshops can, and do, alter the type of books sourced from publishers. For example, up until two years ago, UBS was primarily involved in retailing educational textbooks. It has since increased its volume of front-list titles, which now account for approximately [ ] % of its total book sales. Ken McIntyre, Managing Director, UBS advised the Commission that UBS's only requirement to increasing the volume of front-list sales was space to store and display books. Likewise, Chris Hart, Managing Director, Real Groovy, advised the Commission that Real Groovy has traditionally stocked a wide range of titles, but has recently narrowed its offering to focus on a niche range of titles. Mr Hart advised that should Real Groovy choose to expand its range of titles again, it could do so easily and by using its existing supplier relationships.
54. Whilst there are varying product and service offerings provided by book retailers, the Commission considers the extent of differentiation is not such that different types of book retailers comprise discrete markets.

### *Book Publishing/Supply*

55. Whilst the proposed acquisition primarily involves aggregation at the retail level, in this Decision, the Commission also considers the competitive impact on the upstream market for the publishing and supply of books to retailers. The Commission recognises that at least some publishers are concerned that the acquisition might give ARW undue power to influence the publishing market.
56. Retailers source books from publishers who are New Zealand-based, or by parallel importing from overseas wholesalers. As with the book retail market, the market for the publishing and supply market is characterised by an array of participants, which differ from one another in terms of company size, corporate structure and titles offered.

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<sup>18</sup> Some retailers, such as Borders, stock a wide range of different genres, whereas other retailers, such as Real Groovy, focus their book offering on specific subject areas.

<sup>19</sup> For example, department stores like The Warehouse and Kmart mostly stock front-list and popular back-list titles. Some bookshops, such as Paper Plus and Whitcoulls, stock front-list and a limited range of back-list titles. Others, such as Dymocks and Borders, stock both front-list titles and a wide range of back-list titles.

<sup>20</sup> Service offerings include staff experience and knowledge, and in-store promotions. For example, [ ] advised the Commission that it does not compete with the likes of ARW on price, but instead differentiates itself from other book retailers by providing a quality service experience for its customers. Similarly, [ ] advised the Commission it has a policy of having high staff numbers to ensure that customers can readily seek advice when browsing titles in-store.

57. Because publishers hold copyrights for given titles only, retailers maintain a portfolio of book publishers and wholesalers through which they source their title range. Outside of parallel importing titles from an overseas wholesaler, there is limited ability for retailers to switch to sourcing a specific title from other publishers. In the short-term some books may be so popular, Harry Potter for instance, that it could be argued that the lucky publisher may have “market power” for a period. Over the longer term however, one book can be considered to be substitutable for another.
58. For the purposes of assessing the competitive effects of the proposed acquisition on the upstream market, the Commission considers that it is appropriate to utilise the one wholesale market - that for the publishing/supply of books to retailers.

### **Conclusion on Product and Functional Dimensions**

59. Whilst bricks-and-mortar book retailers differ from one another in terms of the range of product and services on offer, the Commission considers that the degree of differentiation is not sufficient to justify placing different types of bricks-and-mortar book retailers into discrete markets.
60. The Commission has considered whether the relevant market also includes online book retailers and second-hand book retailers. For the purpose of considering this fact scenario, the Commission has excluded online retailers from the relevant market. The Commission notes that for some consumers online retailers are an adequate substitute for bricks-and-mortar retailers, and duly takes this into account in the competition analysis. The Commission also acknowledges that in other fact scenarios, it may be desirable to review this definition of the book retail market.
61. There may be some degree of substitutability between second-hand books and new books; however, for the purpose of assessing the current Application, the Commission considers the extent of substitutability does not warrant including second-hand book retailers in the relevant market.
62. In respect of publishing and supply of books, the Commission is of the view that whilst market participants vary in terms of corporate structure, size, genres and titles published, the extent of substitutability on the supply-side suggests that the degree of differentiation is not as significant as to warrant discrete markets for the different types of publishers and suppliers.
63. Accordingly, the Commission concludes the relevant product and functional dimension to be:
- the retail of books by bricks-and-mortar book retailers (*the book retailing market*); and
  - the publishing and supply of books to retailers (*the book publishing/supply market*).

### **Geographic Dimension**

#### *The Book Retailing Markets*

64. The Applicant submitted a national market for the retail of books, but considered that, should the Commission not accept this approach and instead adopt a narrower geographic market, a local market would encompass the

region within approximately 7 km of the Borders stores subject to the acquisition.

65. The Applicant compared and contrasted the geographic extent defined by the Commission in respect of supermarkets in Decisions 438 and 448.<sup>21 22</sup> The Applicant submitted that it considers 7 km to be appropriate for books because groceries typically include bulky products (which makes transport and distance a more critical factor) and books are less frequently purchased by consumers than groceries (consumers will be more willing to travel further when purchasing a book).
66. In *HMV Group and Ottakar's*, the UKCC considered a local market which was concentrated on nearby stores (within the same shopping location), and also out-of-town stores which may themselves be shopping destinations, such as supermarkets and Borders' superstores. As neither HMV Group nor Ottakar's have destination stores, the UKCC's assessment was more localised in scope.
67. Book retailers canvassed by the Commission disagreed with the Applicant's submission of a local market with a 7 km radius, advising that most book purchasers are more likely to walk to other bookshops within a particular shopping district than travel to another shopping district. Generalist bookshops<sup>23</sup> advised the Commission that they rely on drop-in customers, so are located in key shopping precincts with high foot traffic. For example, [ ] advised it selects retail sites near a supermarket or food-court in a shopping mall.
68. Specialist bookshops which view themselves as destination stores, such as Dymocks, Unity, and Borders, advised the Commission that they are able to attract customers from beyond the immediate shopping precinct; however, location and customer accessibility remains an important consideration. For example, Don Grover, CEO, Dymocks advised the Commission it relocated to Queen Street because the Atrium had lost popularity as a shopping centre,<sup>24</sup> and whilst its Newmarket store is relatively close to its Queen Street store, the two stores do not compete to any great extent for customers. Similarly, Unity advised it would only consider relocating from High Street if it could identify a new site close-by and located within the Auckland CBD shopping precinct. This might suggest that the scope of the geographic market is more like the local market considered by the UKCC in *HMV Group and Ottakar's*.
69. In any case, whilst ARW has stores throughout New Zealand, Borders only has stores in Auckland, Wellington and Christchurch. On the face of it, if competition concerns were to arise from this acquisition, those concerns are likely to be greater in respect of a local retail market than for a national retail market. That is to say, a narrow market would better highlight the competition effects of the proposed acquisition, and that if there are no competition concerns

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<sup>21</sup> Decision 438, *Progressive Enterprises Limited / Woolworths (NZ) Limited*, 13 July 2001; and Decision 448, *Progressive Enterprises Limited / Woolworths (NZ) Limited*, 13 December 2001.

<sup>22</sup> In Decision 438 and Decision 448, the Commission considered the relevant markets to be the market for the retailing of food, liquor and grocery items in supermarkets. The geographic dimension was defined as incorporating regional markets of not less than 5 km in radius, but recognizing that there is not a uniform size of market that applies to all areas, but a range of small sizes that reflect a variety of factors influencing how far consumers will be willing to travel to an alternative source of supply if faced with a SSNIP.

<sup>23</sup> Generalist bookshops include the likes of Whitcoulls and Paper Plus.

<sup>24</sup> The Atrium shopping centre is located in Elliot Street, Auckland CBD.



that arise within the narrow market, competition concerns are unlikely to arise within a wider (regional or national) market.

70. ARW does not have a store in Sylvia Park. For this reason, the Commission has taken the view that aggregation is unlikely to occur in this market as a result of the proposed acquisition.<sup>25</sup>

#### *The Book Publishing/Supply Market*

71. In *Woolworths Group Plc and Bertram Group Limited*,<sup>26</sup> the UKCC noted that suppliers serve the whole of the UK using common pricing and terms of business, and there did not appear to be any grounds for believing that there was any geographical segmentation of the market.
72. Publishers interviewed by the Commission advised they distribute books to retailers located throughout New Zealand, and pricing and terms are uniform across the country.
73. The Commission is therefore of the view that the book publishing/supply market is national in scope.

#### **Conclusion on Geographic Dimension**

74. The Commission accepts the view that in general the principal competition faced by an individual retailer comes from other retailers within walking distance. It recognises that some consumers are prepared to travel further, or use the internet, to take advantage of lower prices or higher level of service which might be available elsewhere. However for the purpose of the analysis below it is assumed that these consumers in themselves are not sufficiently numerous for their behaviour to constrain retailers. Accordingly the Commission has adopted the conservative approach of defining geographic markets which coincide with the shopping district surrounding each book retailer. While such markets may be unduly limited, the Commission recognises that if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.
75. Accordingly, the Commission concludes the relevant geographic markets for the book retailing to be the Auckland CBD (not including Newmarket), Albany, Wellington CBD (including Lambton Quay, Willis Street, Courtney Place and Cuba Street) and Riccarton shopping precincts.
76. In respect of the book publishing/supply market, the Commission considers that the book supply-chain suggests the scope of the market is national, and notes this is consistent with the market defined by the UKCC in *Woolworths Group Plc and Bertram Group Limited*.
77. Accordingly, the Commission concludes the relevant geographic market for the book publishing/supply market is New Zealand.

#### **CONCLUSION ON MARKET DEFINITION**

78. The Commission concludes, for the purpose of assessing the competition implications of the proposed acquisition, the relevant markets are:

<sup>25</sup> ARW advised the Commission that the nearest Whitcoulls store to Sylvia Park is Pakuranga, which is approximately 5 km away. For the purpose of assessing this fact scenario, the Commission has considered Westfield Pakuranga and Sylvia Park to comprise separate shopping precincts.

<sup>26</sup> UKCC, *Woolworths Group Plc and Bertram Group Limited*, 4 September 2007.

- the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts (*the book retail markets*); and
- the publishing and supply of books to retailers in New Zealand (*the book publishing/supply market*).

#### COUNTERFACTUAL AND FACTUAL

79. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).<sup>27</sup> The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

#### Factual

80. The Applicant submitted that in the factual, ARW will own and operate Borders under the existing Borders brand.
81. A number of publishers informed the Commission that in the past, ARW has acquired book retailers and either closed or converted these retailers to ARW stores, and therefore consider that ARW is likely to do the same should it acquire Borders.
82. ARW advised the Commission that it has no plans to close or convert existing Borders stores to the Whitcoulls brand, and it will proceed with the intended opening of Borders in Albany in November 2007.

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83. Borders advised the Commission that ARW's operation of the Borders stores in the factual will be subject to the Borders Brand Licensing Deed. Borders Group Inc.'s intention is that the applicable standards, specifications and procedures in the Brand Licensing Deed, which is currently under negotiation, will be in line with those currently observed by the Borders Australia and New Zealand subsidiaries. Subsidiaries are currently provided with guiding principles in respect of various facets of Borders' operations - from selecting and building Borders stores, to day-to-day operations, such as merchandising, product selection, product branding, customer service standards and store presentation.
84. For the purpose of assessing the competition implications of the proposed acquisition, the Commission considers the factual scenario to be that ARW will own and operate Borders in New Zealand. Although ARW has stated that it intends to continue to operate Borders store under the Borders banner, which will be subject to the Borders Licence Deed, the Commission is of the view that ARW will be in a position to change this strategy should it wish to do so.

<sup>27</sup> *Air New Zealand & Qantas Airways Ltd v Commerce Commission* (No.6), (2004), 11, TCLR 347  
Hansen J and KM Vautier, Para 42.

<sup>28</sup>

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**Counterfactual**

85. Borders informed the Commission that  
[  
  
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86. [ ].
87. Accordingly, the Commission considers the most likely counterfactual to be that Borders will be acquired by a third party that would not give rise to a substantial lessening of competition in any market.

**COMPETITION ANALYSIS****The Book Retailing Markets***Existing Competition*Present Competition in the Relevant Markets

88. The Applicant submitted that the combined entity would continue to face constraint from existing competition in the form of established chain stores, such as Dymocks and Paper Plus, independent bookshops, such as Unity and Parsons, and department stores, such as The Warehouse and Kmart.
89. Table 1 shows the estimated market shares for the book retail markets. Market shares presented are for revenue generated by book sales for the 2006/07 financial year.

**Table 1: Estimated Market Shares for the Book Retail Markets (2006/07 FY)**

Retail Store	Market Shares (Revenue for Book Sales 2006-07 FY)			
	Auckland CBD	Albany	Wellington CBD	Riccarton
ARW	[ ]%	[ ]%	[ ]%	[ ]%
Borders	[ ]%	[ ]% <sup>29</sup>	[ ]% <sup>30</sup>	[ ]%
<i>Combined Entity</i>	[ ]%	[ ]%	[ ]%	[ ]%
Paper Plus	-	[ ]%	[ ]%	[ ]%
Dymocks	[ ]%	-	[ ]%	-
The Warehouse	-	[ ]%	-	[ ]%
Kmart	-	[ ]% <sup>31</sup>	-	[ ]%
Real Groovy	[ ]%	-	[ ]%	-
UBS	[ ]%	-	-	-
Parsons	-	-	[ ]%	-
Unity	[ ]%	-	[ ]%	-
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Current CR3</b>	[ ]%	[ ]%	[ ]%	[ ]%
<b>CR3 Post Acquisition</b>	[ ]%	[ ]%	[ ]%	[ ]%

Source: Industry Participants

90. As discussed in the context of industry background, book retailers include department stores, generalist bookshops, specialist bookshops or niche bookshops.
91. The Applicant submitted that ARW and Borders target different demographics<sup>32</sup> and have “overlapping but distinct product spaces”. Further, ARW advised the Commission that competition between Whitcoulls and Borders is not as significant as competition between Whitcoulls and other generalist book retailers, such as Paper Plus, and competition between Borders and other specialist book retailers, such as Dymocks.<sup>33</sup>
92. Industry participants were of the view that, as a generalist bookshop, Whitcoulls’ closest competitors are those which are primarily engaged in price competition (mostly on front-list titles), such as department stores like The Warehouse, and other generalist bookshops like Paper Plus. However, all industry participants interviewed by the Commission advised that price competition and non-price competition does occur between generalist bookshops and other types of book retailers.
93. Andrew Robertson, Chief Financial Officer, Paper Plus, advised the Commission that he considers Paper Plus would be a key competitor to the combined entity in the factual scenario, given Paper Plus’s network of franchises, similar product offerings to Whitcoulls, and its relationship with Fly Buys. Paper Plus stores  
[

<sup>29</sup> Borders Albany opened on 22 November 2007. The market share is based on the projected turnover for book sales in the first year of operation.

<sup>30</sup> As this store has only recently opened, market share is based on the projected turnover for book sales in the first year of operation.

<sup>31</sup> Kmart Albany opened in September 2007. The market share is based on the projected turnover for book sales in the first year of operation.

<sup>32</sup>

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<sup>33</sup> Although, it should be noted that the Applicant did not go so far as to submit that because it considers ARW and Borders to not be in strong competition, the acquisition in question is unlikely to result in a substantial lessening of competition.

]. Furthermore,

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94. Department stores, such as Kmart and The Warehouse, generally offer a range of titles limited to front-list and popular back-list titles, and compete on price with generalist bookshops, like ARW, through promotions and specials.

[

]. For this reason, The Warehouse has become a key competitor in terms of price.

95. ARW advised the Commission that The Warehouse uses popular titles, such as children's books like the Harry Potter series, or sporting books like Tana Umaga's biography, as loss leaders and ARW cannot compete on price with The Warehouse on these titles. Accordingly, ARW has altered its purchasing pattern to reflect the growth of The Warehouse's presence in book sales. For example, in the past ARW would have purchased [ ] copies of a title, whereas nowadays it might only purchase [ ] copies of that title from its publisher.

96. Specialist bookshops, which do not typically engage in pricing competition to the same extent as department stores and generalist bookshops, did generally consider themselves to be in closer competition with Borders than Whitcoulls, focussing on non-price attributes<sup>34</sup>. However, as mentioned in paragraph 92, these retailers still considered themselves to be in competition with generalist bookshops like Whitcoulls.

97. For example, when Borders opened its store in Lambton Quay in March 2007,

[

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98. Conversely, niche bookshops interviewed by the Commission, such as Real Groovy, advised that they do not consider themselves to be strong price-competitors to either Borders or Whitcoulls. In respect of non-price attributes, these niche bookshops considered they compete to some degree with Borders, and to a lesser extent with Whitcoulls.

99. The Applicant submitted that supermarkets will also act as a constraint in the retail book markets.

[

]. In any case, retailers canvassed by the Commission expressed the view that supermarkets are not involved in book retailing to any great extent. The Commission has not considered supermarkets in its assessment of existing competition in this fact scenario.

100. The Commission now turns to examine the competitive impact of the proposed acquisition in each of the retail book markets.

### Competitive Impact of the Acquisition

#### **Auckland CBD Book Retail Market**

<sup>34</sup> Non-pricing attributes include title range and value added services (e.g., service quality, and providing a pleasant environment).

101. ARW has four bookshops in the Auckland CBD market: a large Whitcoulls store on Queen Street, smaller Whitcoulls stores on Karangahape Road and in the Downtown shopping centre, and a Bennetts store on campus at Auckland University of Technology (AUT).
102. Table 1 indicates that in the Auckland CBD book market, ARW currently has a market share of [ ] %, which will increase to [ ] % in the factual. The three-firm concentration ratio will increase from [ ] % to [ ] %. This falls outside of the Commission's safe harbours.
103. Dymocks and Unity would be the combined entity's most significant competitors in the factual, with [ ] % and [ ] % market share, respectively. Both Dymocks and Unity are specialist bookshops (like Borders) which compete mostly on non-pricing attributes; they provide a wide range of back-list titles, and provide value-added services. That is to say that they fill similar spaces in this differentiated market.
104. Dymocks advised the Commission that it does participate in some pricing activity against ARW and Borders. Conversely, Unity advised the Commission that it does not generally engage in price competition.
105. [ ]; however, approximately [ ] % of UBS' book sales are educational textbooks – the remainder of which comprise sales of general titles.<sup>35</sup> Ken McIntyre, CEO, UBS advised the Commission that UBS competes on price, to some small extent, with bookshops like Whitcoulls, Unity and Dymocks for sales of its general titles. It is mostly involved in competition on non-pricing attributes with the likes of Bennetts for textbook sales.
106. The Commission therefore considers that post-acquisition, Dymocks, and to a lesser extent, UBS, are likely to continue to provide constraint in terms of price competition. In respect of non-price competition, the Commission considers that Dymocks, Unity, and to a lesser degree UBS, are likely to continue to provide constraint.

### **Albany Book Retail Market**

107. ARW has three bookshops in the Albany book market: a Whitcoulls store located in the Albany Mega Centre, a Whitcoulls store located in Westfield Albany shopping centre, and a Bennetts store located on campus at Massey University.
108. Table 1 indicates that in the Albany book retail market, ARW currently has a market share of [ ] %, which will increase to [ ] % in the factual. The three-firm concentration ratio will increase from [ ] % to [ ] %. This falls outside of the Commission's safe harbours.
109. Post-acquisition, the combined entity's competitors will be a few smaller players: Paper Plus, The Warehouse, and Kmart. These book retailers each have a market share of [ ].
110. Presently, Paper Plus and The Warehouse actively compete against Whitcoulls on price. The Commission considers that in the factual, these parties are likely to continue to act as a constraint in terms of pricing factors.

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<sup>35</sup> General titles comprise front-list and popular back-list titles.

111. Paper Plus participates in non-price competition to some extent, but other than Borders, there is presently no other book retailer in the Albany market which primarily competes on non-pricing attributes, and this will not change post-acquisition.
112. Kmart's Albany store opened in September 2007.  
[ ].

### **Wellington CBD Book Retail Market**

113. ARW has three bookshops in the Wellington CBD market: Whitcoulls Lambton Quay, Whitcoulls Cuba Street, Whitcoulls Courtenay Place, and Bennetts Lambton Quay.
114. Table 1 indicates that in the Wellington CBD book market, ARW currently has a market share of [ ]%, which will increase to [ ]% in the factual. The three-firm concentration ratio will increase from [ ]% to [ ]%. This falls outside of the Commission's safe harbours.
115. Similar to the Auckland CBD market, in the factual, Dymocks and Unity are likely to be the combined entity's greatest competitors, with [ ]% and [ ]% market share, respectively.
116. [ ]. Several publishers advised the Commission that the Dymocks Lambton Quay store is known as one of the best performing stores in the Dymocks Group,<sup>36</sup> and is a strong competitor to both ARW and Borders on both pricing and non-pricing attributes.
117. Dymocks confirmed these statements, advising the Commission that its Lambton Quay store is a vigorous competitor to ARW, and more recently, Borders. When Borders opened its new Lambton Quay store in March 2007, Dymocks responded by offering more discounted product lines, increasing its radio marketing, and securing additional book signings. The Commission considers that, post-acquisition, Dymocks Lambton Quay is likely to continue to provide constraint on the combined entity in terms of price and non-price factors.
118. As with the Auckland CBD market, the Commission considers that Unity is likely to continue to provide constraint in respect of non-price attributes.
119. There are several other small bookshops in the Wellington CBD market, which have a combined market share of [ ]. These stores include those which mostly compete on price, such as Paper Plus; and those which mostly compete in terms of non-pricing attributes, such as Parsons (a specialist bookshop), Capital Books and Real Groovy (which are both niche bookshops). The Commission considers that these book retailers are likely to provide some degree of constraint, post-acquisition.

### **Riccarton Book Market**

120. ARW has two Whitcoulls stores in the Riccarton market, one located at Westfield Riccarton and one located at Bush Inn shopping centre.
121. Table 1 indicates that in the Riccarton book market, ARW currently has a market share of [ ]%, which will increase to [ ]% in the factual. The three-

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<sup>36</sup> Dymocks Lambton Quay has won Group Bookstore of the Year for six of the last seven years.

firm concentration ratio will increase from [ ]% to [ ]%. This falls outside of the Commission's safe harbours.

122. The market structure of the Riccarton shopping precinct is similar to that of Albany: in the factual, the remaining competitors to the large combined entity will be a few smaller players, each with market shares [ ].
123. Post-acquisition, the Commission considers that the combined entity will continue to face price competition from Paper Plus, which has a market share of [ ]%, and The Warehouse, which has a market share of [ ]%. In addition, the Commission is of the view that Paper Plus will provide some degree of constraint on non-pricing attributes. Other than Borders, there is presently no other book retailer in the Riccarton market which primarily competes on non-pricing attributes, and this will not change post-acquisition.
124. As with the Albany market, [ ].

#### Expansion of Existing Competitors

125. The Applicant submitted that existing competitors can easily expand their range and offer a wider variety of book genres and titles by adding to existing product lines and by using existing capacity. Adding extra capacity could be easily achieved within three to six months by expanding existing premises, relocating or opening additional retail store premises.
126. Industry participants canvassed by the Commission for the most part agreed with the Applicant's view of expansion of existing competition; the key requirements to expansion are retail space and access to books. No-one spoken to by the Commission considered access to additional books to be particularly difficult.
127. Book retailers, such as Unity and Parsons, commented that the requirement for additional space would generally necessitate relocation to a larger site within that shopping district. However, availability of retail space was not cited as a particularly challenging task, as new sites frequently become available.<sup>37</sup>
128. Given the apparent ease with which existing competitors could source additional books through existing supplier relationships, and the availability of retail space the Commission is of the view that existing competitors could easily expand to exert additional constraint on the combined entity in the factual scenario.

#### *Conclusion on Existing Competition*

129. In respect of the Auckland CBD market, the Commission considers that post-acquisition the combined entity is likely to face some extent of price competition from Dymocks. The Commission is of the view that the combined entity will continue to face constraint in terms of non-pricing attributes from Unity and Dymocks, and to a lesser extent, niche bookshops such as Real Groovy and UBS, due to their fragmented nature and limited subject range.
130. In the Wellington CBD market, the Commission considers that post-acquisition, Dymocks, and to a lesser extent Paper Plus, are likely to continue to compete with the combined entity on price. In respect of non-pricing attributes, the

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<sup>37</sup> Dymocks expressed the opinion that identification of a suitable site could be difficult and timely, although was able to relocate from the Atrium to Queen Street in Auckland CBD within eighteen months to two years.



Commission is of the view that the combined entity will continue to face constraint from Unity and Dymocks, and to a lesser extent, other small bookshops such as Parsons, Paper Plus and niche bookshops, due to their fragmented nature.

131. The Albany and Riccarton shopping precincts have a similar market structure, whereby there are three remaining competitors to the combined entity in the factual. The Commission considers that in these two markets, the combined entity is likely to face pricing competition from each of The Warehouse and Paper Plus, and to a lesser extent, Kmart. Paper Plus is likely to provide some competition on non-pricing attributes. Other than Borders, there is presently no book retailer in the Albany or Riccarton shopping precincts that primarily competes on non-pricing attributes and this is unlikely to change post-acquisition.
132. The Commission notes that retailers which presently have a narrow title range are able to expand their title range should market circumstances change.
133. Accordingly, the Commission concludes that the combined entity is likely to continue to face constraint from existing competition in the factual scenario in the markets for the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts.

#### *Potential Competition*

134. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any barriers they might encounter should they try.
135. The Applicant submitted that the ease with which a new player could enter the market would continue to act as a constraint on the combined entity. The Applicant considers barriers to entry to be low, and cited the entry of a number of market participants in recent years as evidence of this.<sup>38</sup>

#### Entry Conditions

136. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of the aggregate barriers to entry into that market.
137. Book retailers spoken to by the Commission advised that the key entry requirements would be: a retail site in a suitable location; access to a book supply; experienced staff; and IT systems.

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<sup>38</sup> For example, *de novo* entrant Borders, which entered New Zealand with its first store in Auckland in 1999, and has since opened four new stores since 2005 in Riccarton, Lambton Quay, Sylvia Park, and Albany; existing market players Paper Plus and Dymocks, which have opened new franchised stores in various locations throughout New Zealand; and existing department store The Warehouse, which expanded its product range to include books.

138. As discussed previously, in general, industry participants did not consider identification of a suitable retail site to be a particularly onerous task, as retail space frequently becomes available, even in prime shopping locations.<sup>39</sup>
139. Paper Plus advised the Commission that in some situations, securing a prime retail location can be expensive, and might mean that it would be uneconomic for an owner-operator, such as a franchisee or independent retailer, to open a store in that shopping precinct. However, the Commission notes that Paper Plus and Dymocks, which are franchise chain-stores, have overcome this hurdle by opening group-owned stores (as in the case of Paper Plus Sylvia Park), and forming a joint venture with a franchisee (as in the case of Dymocks Queen Street). The Commission is therefore of the view that it is likely there is sufficient available retail space such that securing an appropriately located retail site is unlikely to constitute a significant barrier to entry.
140. The Applicant submitted that established chain stores and department stores do not enjoy substantially better buying terms compared to smaller independents, and that irrespective of size, established chain stores, independent book retailers, and new entrants can purchase the same book titles on similar terms and at a similar price.
141. Whilst no one spoken to by the Commission cited access to supply of books as being overly difficult, they all considered that established chain stores, such as ARW, would have the advantage of being able to use their larger scale to negotiate favourable terms and discounts.<sup>40</sup> For example, Michael Moynihan, Managing Director, Random House advised the Commission that the discount secured by a book retailer varies from [ ], through to [ ]. These compare with [ ]% and [ ]% (depending on whether on a sale-and-return basis or a fixed basis) for ARW.
142. Some smaller book retailers advised the Commission that in cases where they are not able to negotiate favourable discounts, they parallel import titles to ensure they can source books at the lowest possible price and remain competitive. For example, Unity imports approximately [ ]% of its titles in stock through overseas book wholesalers.
143. Experienced staff and IT systems were not considered to be problematic in terms of requirements for entry. A number of industry participants advised that off-the-shelf IT systems are readily available, and used by retailers and publishers alike, e.g., the Thorpe Barker Database.
144. Taking into consideration the availability of retail space, ease of access to books, experienced staff and IT systems, the Commission considers that entry conditions are not such as to constitute barriers that would hinder new entry in the factual scenario.

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<sup>39</sup> Whilst Dymocks expressed the view that securing an ideal retail site is difficult, the Commission notes that Dymocks has been able to secure prime retail sites for its stores in Queen Street (Auckland CBD), Broadway (Newmarket), Lambton Quay (Wellington CBD), Queensgate (Lower Hutt), and has further stores opening in Tauranga and Hamilton. Dymocks did advise that [ ].

<sup>40</sup> As discussed in the industry background, the commercial terms offered by publishers to retailers are typically expressed as a discount off recommended retail price.

### The LET Test

145. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:
- Likely in commercial terms;
  - sufficient in Extent to cause market participants to react in a significant manner; and
  - Timely, i.e., feasible within two years from the point at which market power is first exercised.

### **Likelihood**

146. Many industry participants canvassed by the Commission expressed the view that New Zealand has reached saturation point in terms of bookshops.
147. Nevertheless, existing book retailers advised the Commission they have plans to expand their network of bookshops, and in some cases, this includes the four local markets relevant to this Decision.
148. Dymocks does not operate retail stores in the Albany or Riccarton shopping precincts, and it does not currently have a presence in the South Island at all.  
[

].

149. [

].

150. For these reasons, the Commission considers entry from existing book retailers to be likely in the event of any attempt by the merged company to exercise market power post-acquisition.

### **Extent**

151. All book retailers spoken to by the Commission advised that new store openings have an immediate impact on the sales of other book retailers within that vicinity, due to the novelty value. For example, when Borders opened its new store in Lambton Quay, Dymocks, Parsons, and ARW all experienced an immediate decrease in sales of between [ ] %.  
[  
].
152. The Commission is of the view that, to this extent, any significant new entry is likely to have an immediate impact on existing book retailers in these four markets. If the new entrant provides a price/service mix which customers find attractive, it is likely that the impact of new entry will be felt beyond this initial period.
153. Furthermore, as discussed previously, it is likely that once a book retailer has established itself in a market, it would not face significant barriers to expansion, as it could source additional stock through its existing supplier relationships.

### **Timeliness**

154. Borders advised the Commission that its model for book retailing is unique, and cannot be taken as an example of a typical new entrant. Its stores are usually in excess of 2,000m<sup>2</sup>, and require a custom fit-out. For this reason, when it enters a market it must secure a retail site in a new or expanded shopping complex, and entry by means of a large-scale Borders store can take between two and three years.
155. Comparatively, most other book retailers have shops of less than 1,000m<sup>2</sup>, and are likely to be able to move into existing retail sites with little fit-out required, which would significantly reduce entry time into a market.
156. Dymocks advised the Commission that when it decided to relocate from its store in the Atrium, it took less than two years to identify a suitable retail site and relocate to this site (in Queen Street).
157. Therefore, the Commission is of the view that new entry within two years is feasible in the markets for the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts.

### *Conclusion on Potential Competition*

158. The Commission is of the view that barriers to entry into the relevant book retail markets are not such as to deter new entry in the factual in the event of any party attempting to exercise market power.
159. The Commission considers that new entry is most likely to occur by a book retailer with an existing network of stores in New Zealand, and that entry by such a player is likely to constrain existing players in these markets, post-acquisition. Furthermore, once established in a market, it is likely that a retailer would not face significant barriers to expansion, as it could source additional stock through existing supplier relationships.
160. The Commission considers new entry is feasible within a two-year timeframe.
161. The Commission concludes that post-acquisition, new entry is likely, timely and sufficient in extent to act as a constraint on the combined entity in the markets for the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts.

### *Other Constraints*

162. Although for the purpose of analysing this Application the Commission has not placed internet book retailers within the same market as bricks-and-mortar retailers, it recognises that the internet is a realistic source of books for some consumers.
163. The Applicant submitted that internet book retail already accounts for 5 % of total book sales in New Zealand, and is estimated to be growing at 25 % per annum. If this rate of growth continues, internet book retailers could become an important constraint on bricks-and-mortar book retailers in the near future.
164. Most bricks-and-mortar book retailers spoken to by the Commission agreed with the Applicant's estimate of five percent. Unity advised the Commission that the uptake of internet book retailing in New Zealand has been comparatively slower than overseas – and thought this to be because of non-

pricing attributes offered by many New Zealand book retailers. Similarly, Allen & Unwin advised that it considered there will always be a large proportion of consumers that prefer to visit a bricks-and-mortar store when making book purchases.

165. New Zealand internet book retailers Real Groovy and The Nile confirmed that their online book sales are increasing over time. Jethro Marks, Managing Director, The Nile stated that
- [
- ] in order to ensure it remains competitive with large books-and-mortar retailers on price.
166. In addition, both Real Groovy and The Nile advised that internet book retailers do not face the same constraints that bricks-and-mortar retailers do, and can therefore expand their range of titles and sales volume even more easily than bricks-and-mortar book retailers. For example, Real Groovy's bricks-and-mortar stores only stock a limited range of titles; however, its internet store provides customers with access to almost any title currently in print.
167. Therefore, the Commission considers that internet book retailers are likely to provide some degree of constraint in the factual scenario in the markets for the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts.

### **Conclusion on Book Retail Markets**

168. In respect of the Auckland CBD market, the Commission considers that post-acquisition the combined entity is likely to face some price competition from Dymocks. In respect of non-pricing attributes, the Commission is of the view that the combined entity will continue to face constraint from Unity, Dymocks, and UBS, and to a lesser extent, niche bookshops such as Real Groovy due to their fragmented nature and limited subject range.
169. In the Wellington CBD market, the Commission considers that post-acquisition, Dymocks, and to a lesser extent Paper Plus, are likely to continue to compete with the combined entity on price. In respect of non-pricing attributes, the Commission is of the view that the combined entity will continue to face constraint from Unity and Dymocks, and to a lesser extent, other small bookshops such as Parsons, Paper Plus and niche bookshops.
170. The Albany and Riccarton shopping precincts have a similar market structure, whereby there are three remaining competitors to the combined entity in the factual. The Commission considers that in these two markets, the combined entity is likely to face pricing competition from each of The Warehouse and Paper Plus, and to a lesser extent, Kmart. Paper Plus is also likely to provide some competition on non-pricing attributes. Other than Borders, there is presently no book retailer in the Albany or Riccarton shopping precincts that primarily competes on non-pricing attributes and this is unlikely to change post-acquisition.
171. Furthermore, the Commission is of the view that existing book retailers could expand and provide additional constraint on the combined entity by sourcing additional books through existing supplier relationships, and securing larger retail space. The Commission notes that retailers which mainly compete on price (that is, they focus primarily on front-list titles) are able to expand their back-list range should market circumstances change.

172. The Commission is of the view that anyone seeking to enter the relevant book retail markets is unlikely to face high barriers. New entry is most likely to occur by a book retailer with an existing network of stores in New Zealand, and entry by such a player is likely to constrain existing players in these markets post-acquisition. Furthermore, once established in a market, a retailer would not face significant barriers to expansion, as it could source additional stock through existing supplier relationships. The Commission considers new entry is feasible within a two-year timeframe.
173. For the purposes of assessing this fact scenario, the Commission has excluded internet book retailers from the relevant market; however, it acknowledges that these retailers do currently compete, to some extent, for book sales with bricks-and-mortar retailers. In addition, internet book retailers do not face the same expansion requirements as bricks-and-mortar retailers, and can therefore expand even more easily than bricks-and-mortar retailers. For these reasons, the Commission considers that internet book retailers are likely to provide some degree of constraint in the factual scenario.
174. Accordingly, the Commission concludes that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the markets for the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts.

### **The Book Publishing / Supply Market**

175. The proposed acquisition does not result in any aggregation in respect of the national book publishing/supply market. Nevertheless, the Commission has examined whether the proposed acquisition would result in the combined entity gaining market power as a purchaser in this market. The Commission has consider whether the combined entity could force publishers to behave in a way that they would not be able to in a competitive market.
176. In *HMV Group and Ottakar's*, the UKCC considered the bargaining strength of retailers and publishers, noting:
- “Retailers might have bargaining strength in negotiations with a publisher if they account for a significant proportion of that publisher’s sales and can credibly threaten not to stock some, or all of the publisher’s titles (or could purchase them from a wholesaler, albeit at lower discounts). However, we noted that the size of discounts provided by publishers to retailers might not be strictly related to sales volumes but might also reflect, for example, distribution costs and other factors.
- Publishers will have some bargaining power with retailers because they control the copyright to each title and hence control the supply of that title. This is particularly important for ‘must stock’ titles, but matters for all titles to the extent that readers do not regard one title as a good substitute for another. In addition ... concentration among publishers is increasing.”<sup>41</sup>
177. ARW’s purchases currently account for approximately [ ] % of books supplied by New Zealand publishers. The next largest are Paper Plus, Dymocks and The Warehouse, [ ]. Borders has for some time only purchased comparatively small quantities of books; however, upon expanding its presence as a book retailer in New Zealand, it also increased the volume of books acquired from publishers. It is anticipated that with the opening of the

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<sup>41</sup> *HMV Group and Ottakar's*, para 5.80 – 5.81.

new Borders store in Albany, it will be [ ].<sup>42</sup>

178. Publishers have suggested that increased buyer power on the combined entity's part would most likely manifest as:
- demanding discounts at supra-competitive levels, which could impact upon the viability of the publishing business; and
  - choosing not to stock a title, which could impact upon the viability of the print run.
179. [ ] explained that ARW does secure higher discount rates than some other book retailers, but for the most part this is a reflection of the economies of supplying a larger number of books to a central distribution centre, and whether or not the book is acquired on a sale-and-return, or a firm basis. For example, as mentioned previously, [ ]].
180. [ ] advised the Commission that, in any case, the volume of books acquired by ARW has been decreasing, and the volume of unsold books returned for credit has been increasing. From September 2006 to September 2007, ARW's share of books acquired from [ ] decreased from [ ]. [ ]].
181. [ ] attributes the decrease in purchases to ARW implementing a more conservative purchasing programme – ARW seems to avoid acquiring more copies of a title than it can sell in its stores, particularly those which may be used as loss leaders by The Warehouse. Similarly, [ ]].
182. [ ] advised the Commission that publishers do hold some bargaining power in terms of being the copyright holder on particular titles. Whilst [ ] said ARW uses the option of parallel importing in negotiations, it did agree with [ ] - there are some titles which ARW does not have the option of parallel importing.
183. Some publishers, [ ], expressed a concern that if the combined entity chose not to stock a particular title, then the viability of that print run might be affected, such that it may no longer be economic to print that title. The Commission put this concern to ARW, which advised that it could not risk rejecting a new release title, as it would risk losing customers to its competitors that choose to pick up that title. Even in instances where [ ], ARW continues carrying that title to maintain its market presence. Large publisher [ ] agreed that whilst ARW is an important outlet for newly published books, it would not be rational for ARW to reject a book recommended by a publisher as a popular new title.
184. In any case, [ ] advised the Commission that it considers ARW is already in a position to influence print runs in this way, hence this situation would not materially change in the factual.

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<sup>42</sup> Figures are an approximation based on data collected from Random House, Allen & Unwin, and Penguin.

185. The Commission considers there is clearly an interdependent relationship between publishers and retailers, and this would remain the case post acquisition. Whilst ARW would become a larger retailer, the Commission does not consider that it would have undue market power in the retail market. Accordingly, any increased strength it may have as a buyer is not likely to significantly affect the current level of competition in the upstream supply market.
186. The Commission concludes that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the market for publishing and supply of books to retailers in New Zealand.

## CONCLUSION

187. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition in the markets for:
- the retail of books by bricks-and-mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton shopping precincts (*the book retail markets*); and
  - the publishing and supply of books to retailers in New Zealand (*the book publishing market*).
188. The Commission considers that the most likely counterfactual scenario is that Borders will be acquired by a third party that would not give rise to a substantial lessening of competition in any market.
189. In respect of the Auckland CBD market, the Commission considers that post-acquisition the combined entity is likely to face some price competition from Dymocks. The Commission is of the view that the combined entity will continue to face constraint in terms of non-pricing attributes from Unity, Dymocks, and UBS, and to a lesser extent, niche bookshops such as Real Groovy due to their fragmented nature and limited subject range.
190. In the Wellington CBD market, the Commission considers that post-acquisition, Dymocks, and to a lesser extent Paper Plus, are likely to continue to compete with the combined entity on price. In respect of non-pricing attributes, the Commission is of the view that the combined entity will continue to face constraint from Unity and Dymocks, and to a lesser extent, other small bookshops such as Parsons, Paper Plus and niche bookshops, due to their fragmented nature.
191. The Albany and Riccarton shopping precincts have a similar market structure, whereby there are three remaining competitors to the combined entity in the factual. The Commission considers that in these two markets, the combined entity is likely to face pricing competition from each of The Warehouse and Paper Plus, and to a lesser extent, Kmart. Paper Plus is also likely to provide some competition on non-pricing attributes. Other than Borders, there is presently no book retailer in the Albany or Riccarton shopping precincts that primarily competes on non-pricing attributes and this is unlikely to change post-acquisition.
192. The Commission is of the view that existing book retailers could expand and provide additional constraint on the combined entity by sourcing extra books through existing supplier relationships, and securing larger retail space. The Commission notes that retailers which mainly compete on price (that is, they



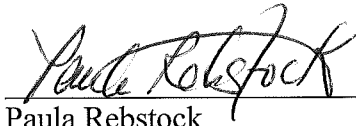
focus primarily on front-list titles) are able to expand their back-list range should market circumstances change.

193. Regarding constraint from potential competition, the Commission is of the view that anyone seeking to enter the relevant book retail markets is unlikely to face high barriers. New entry is most likely to occur by a book retailer with an existing network of stores in New Zealand, and entry by such a player is likely to constrain existing players in these markets post-acquisition. Furthermore, once established in a market, a retailer would not face significant barriers to expansion, as it could source additional stock through existing supplier relationships. The Commission considers new entry is feasible within a two-year timeframe.
194. For the purposes of assessing this fact scenario, the Commission has excluded internet book retailers from the relevant market; however, it acknowledges that these retailers do currently compete, to some extent, for book sales with bricks-and-mortar retailers. In addition, internet book retailers do not face the same expansion requirements as bricks-and-mortar retailers, and can therefore expand even more easily than bricks-and-mortar retailers. For these reasons, the Commission considers that internet book retailers are likely to provide some degree of constraint in the factual scenario.
195. Whilst the proposed acquisition does not result in any aggregation in respect of the upstream publishing/supply market, the Commission has examined whether the proposed acquisition would result to the combined entity gaining market power as a purchaser in this market. The Commission considers there is clearly an interdependent relationship between publishers and retailers, and this would remain the case post-acquisition. Although ARW would become a larger retailer, the Commission does not consider that it would have undue market power in the retail market. Accordingly, any increased strength it may have as a buyer is not likely to significantly affect the current level of competition in the upstream supply market.
196. The Commission is therefore satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any market.

**DETERMINATION ON NOTICE OF CLEARANCE**

197. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition of 100 % of the shares in Borders New Zealand Limited by A&R Whitcoulls Holdings Group Pty Limited, or an interconnected body corporate of A & R Whitcoulls Holdings Group Pty Limited.

Dated this 20<sup>th</sup> day of November 2007



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Paula Rebstock  
Chair

**APPENDIX 1: OTHER PARTIES****Bricks-and-Mortar Book Retailers**

- Dymocks Franchise Systems (NZ) Limited (*Dymocks*)
- Paper Plus New Zealand Limited (*Paper Plus*)
- Unity Books (Auckland) Limited and Unity Books (Wellington) Limited (*Unity*)
- Real Groovy Records Limited (*Real Groovy*)
- University Bookshop (Auckland) Limited (*UBS*)
- Parsons Books & Music Wellington (*Parsons*)
- Kmart New Zealand (*Kmart*)
- The Warehouse Limited (*The Warehouse*)

**Online Book Retailers**

- Mercury Retail NZ Limited (*The Nile*)

**Publishers/Distributors**

- Addenda Publishing Limited (*Addenda*)
- Allen & Unwin New Zealand Limited (*Allen & Unwin*)
- Pearson New Zealand Limited (*Penguin*)
- Random House New Zealand Limited (*Random House*)
- Awa Press Limited
- Auckland University Press
- Oxford University Press
- Sarah Bennett Books Limited
- Hachette Livre NZ Limited

**Other**

- Book Publishers Association of New Zealand
- Barron Braden
- Mark Rowley