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COMMERCE COMMISSION

Decision No. 451

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

S.C. JOHNSON COMMERCIAL MARKETS, INC.

and

CONOPCO, INC.

The Commission: PR Rebstock

Summary of Application: The acquisition by S.C. Johnson Commercial Markets, Inc, or interconnected body corporate, of the DiverseyLever Group business, which includes the shares and/or business of DiverseyLever New Zealand Limited.

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

Date of Determination: 17 January 2002

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THE PROPOSAL

1. On 12 December 2001 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act"), from S.C. Johnson Commercial Markets, Inc, ("the Applicant"), for it or any interconnected body corporate to acquire the DiverseyLever Group business, which includes the shares and/or business of DiverseyLever New Zealand Limited ("DLNZ").

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 18 January 2002.

3. The Applicant sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 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 determination is based on an investigation conducted by staff.

5. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

S.C. Johnson Commercial Markets, Inc

6. S.C. Johnson Commercial Markets, Inc, is a Delaware corporation, and a wholly owned subsidiary within the Johnson Wax Professional Group. S.C. Johnson Commercial Markets is nominated in the Purchase Agreement as one of the companies which will effect the acquisition of the DiverseyLever business.

7. The Johnson Wax Professional Group remains under the majority beneficial ownership of the descendants of the founder, Samuel Curtis Johnson. In 1999, S.C. Johnson & Son Inc. separated the Johnson Wax business into two entirely independent groups of companies, one of which holds the combined Johnson professional and polymer businesses, and the other holds the Johnson consumer businesses.

8. In New Zealand, the Johnson Wax Professional Group is headed by Johnson Wax Professional New Zealand Limited (JWPNZ).

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

9. JWPNZ's business involves the manufacture and supply of "professional" detergents, cleaning and hygiene products and systems to commercial and institutional customers, (such as hotels, hospitals and commercial cleaning contractors).

Conopco, Inc

10. Conopco is a wholly owned subsidiary of Unilever, an Anglo-Dutch group of companies headed by Unilever PLC of the UK, and Unilever NV of the Netherlands. Conopco has been nominated in the Purchase Agreement as the vendor of the world-wide DiverseyLever companies and businesses. Unilever will take a one third shareholding in a holding company within the Johnson Professional Group for 5 years.

11. Unilever's New Zealand business also includes a separately operated professional detergent supply business, which is headed by DLNZ. DLNZ's business is broadly similar to JWPNZ's in that it comprises the supply of cleaning and hygiene products and systems to commercial and institutional customers. DLNZ's business also extends to industrial customers, particularly in food and beverage cleaning and hygiene chemicals and systems.

OTHER RELEVANT PARTIES

Ecolab

12. Ecolab was founded in 1923 and is a global developer and marketer of premium cleaning, sanitising, pest elimination, maintenance and repair products and services for hospitality, industrial and institutional ("I & I") markets. Customers include hotels and restaurants; foodservice; healthcare and educational facilities; quick service (fast-food) units; commercial laundries; light industry; dairy plants and farms; and food and beverage processors. Ecolab operates directly in 40 countries and has been represented in New Zealand for over 40 years through a wholly owned subsidiary.

Campbell Proclean Limited

13. Campbell Proclean Limited ("CPL") is a wholly owned subsidiary of Campbell Brothers Limited, Australia and operates as a chemical manufacturer. It distributes chemicals and hardware and consumable products to the cleaning industry including:

- Commercial market – building services contractors (BSC);
- Hospitality market – hotels, cafes, kitchens;
- Institutional market – hospitals, rest homes; and
- Educational market – schools, universities.

14. CPL has affiliations with local bodies, government departments (prisons, mental institutions, etc.), and facility management groups. CPL caters for housekeeping, kitchen, laundry on premise, food hygiene, and beverage hygiene. Proclean Products South Island Ltd has no affiliation with CPL.

Advance International Cleaning System (NZ) Ltd

15. Advance International Cleaning System (NZ) Ltd ("Advance") is a privately-owned Auckland based company dealing in industrial vacuums, floor polishers and burnishers, small to ride-on auto floor scrubbers and sweepers, water blasters, chemicals, and janitorial products.

Wilsons Chemicals Ltd

16. Wilson Chemicals Ltd ("Wilsons") is a privately owned company that supplies cleaning chemicals to the food processing industry. In addition to bulk chemicals produced in 20, 200, or 1000 litre containers, Wilson's produce a wide range of five litre products suitable for domestic and small industry operations in the kitchen and laundry areas.

Jasol Limited

17. Jasol Limited ("Jasol") is owned by Jasol Australia, a subsidiary of George Weston Foods Limited. Jasol is a distributor of cleaning products, particularly to the kitchen and food hygiene industries.

Orica New Zealand Limited

18. Orica Australia Pty Ltd is a publicly owned Australian chemical company represented in New Zealand by Orica New Zealand Limited ("Orica"). Orica manufactures and supplies industrial and specialty chemicals, agricultural chemicals and fertilizers, commercial explosives and mining chemicals, paints and other consumer products.

Fernz Chemicals (NZ) Limited

19. Fernz Chemicals (NZ) Limited ("Fernz") is an importer and distributor of industrial and agricultural chemicals. It also services the food and dairy industries and supplies bulk liquid chemicals to the water and wastewater treatment industry, and the pulp and paper industry.

INDUSTRY BACKGROUND

20. The I & I detergent product range extends to hundreds of formulations and a number of different dispensing systems. In New Zealand, manufacturers and wholesale suppliers of I & I detergents and related systems supply either direct to large end-use business customers, or through independent distributors. The distributors add I & I detergent products to other janitorial products, such as toilet tissues, paper towels, buckets and other related product.

21. The suppliers to the New Zealand market of I & I products include three multinational companies and a number of smaller local and trans-Tasman competitors. The multinationals tend to provide innovative products at the high-end of the national market. A focus on dispensing system technology ensures that product is efficiently used. The high-end of the industry is highly service-orientated.

22. Some competitors, including the multinationals, supply product to the market on a nationwide basis, whilst other smaller companies confine their operations to regional areas.

23. Ecolab is the largest manufacturer and wholesaler of most products within the I & I product range. Other competitors have a tendency to focus on specific segments of the market and narrower customer groupings. Industry participants recognise that certain companies have strengths in different segments of the market.

24. In addition to providing a product range and the dispensing technology, some suppliers provide support programmes, training, and occupational health and safety and regulatory compliance advice as part of their ongoing service to the purchaser.

25. In the last few years the commercial products market has gone through a period of mergers and consolidation. For example, DiverseyLever has had four owners in the last six years, and JWP bought Butchers Chemicals in Australia in 2000. In recent times competitors have been faced with a reduction in average margins as the number of chemical product suppliers has risen.

MARKET DEFINITION

26. 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.*

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

28. It is substitutability at competitive market prices that is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

29. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:

– The goods or services supplied and purchased (the product dimension);

– The level in the production or distribution chain (the functional level);

– The geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and

– The temporal dimension of the market, if relevant (the timeframe).

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

31. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

Product Dimension

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

33. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[2] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

34. The Applicant submits that the relevant product market is that for the manufacture and supply of "professional" detergents, cleaning and hygiene products and systems to I & I customers.

Demand-side substitution

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

36. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or

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[2] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable.

37. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.

38. The range of professional products supplied by JWPNZ includes:

- Floor care products and equipment systems;
- Carpet care products and equipment systems;
- General purpose cleaning products;
- Disinfectant cleaning products;
- Restroom care systems;
- Odour control and air care;
- Skin care systems;
- Specialty cleaning products;
- Vehicle wash cleaners;
- Foods safety cleaners and systems;
- Chemical management systems (dilution control dispensers);
- Ware wash (dishwasher) systems; and
- Laundry systems, powder and liquids.

39. In addition to a number of items from the above list, Unilever's business also includes the following items:

- Lubrication (track treatment);
- C.I.P. (Clean In Place) cleaners and equipment; and
- Foaming systems and products.

40. Industry participants confirm that the above lists accurately represent the professional cleaning products range.

41. The Applicant suggests that there are two main end-use customer groupings:

(a) *Industrial customers*: e.g. (factories), which includes the supply of detergents, disinfectants and specialised application equipment used for:

(i) Processed food hygiene;

(ii) Beverage hygiene;

(iii) Dairy hygiene; and

(iv) Agricultural hygiene.

(b) Institutional customers: (e.g. hotels, hospitals, commercial cleaning contractors) which includes the supply of detergents, disinfectants and dispensing systems used for:

(i) Kitchen hygiene;

(ii) House keeping hygiene; and

(iii) Laundry.

42. The Applicant referred the Commission to the European Commission's decision in Unilever/Diversey of March 1996 (*Case No. IV/M.704*) in support of its suggested I & I market definition. The European Commission determined the I & I detergents market to be the relevant market given the degree of substitutability between the product formulation and use in the I & I market, and the fact that the main competitors supplied the full range of I & I products.

43. Although there are two different customer groups, the substitutability between products makes it appropriate to regard I & I detergents and systems as one market.

Supply-side substitution

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

45. The Applicant contends that whilst it does not currently supply industrial customers, it does have a product range available if it wished to enter that sector. JWPNZ suggests that supply side substitutability exists, both in terms of manufacturing capability and product formulations.

46. Industry participants have confirmed that the same technology and manufacturing processes are employed to produce institutional and industrial chemical products.

47. Volume has been cited as the major difference between I & I products. Whereas institutional products tend to be supplied in 5-20 litre packs, industrial products are supplied on a larger scale in thousands of litres. For example, JWPNZ has recently been contracted to deliver to Taylors Group Limited 10,000 litres at a time. The manufacture and supply of I & I products is therefore logistically different although the products themselves are substitutable.

48. I & I purchasers require the same products to clean and sterilise, albeit for use in different places. The products used in the I & I areas are essentially the same, although the testing is different, depending on where the product is used. Industrial products tend to be more highly concentrated than their institutional product counterparts.

Undifferentiated/Differentiated Products

49. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.

50. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.

51. The Applicant notes that I & I detergent products and systems are noticeably differentiated in the following ways:

    - Chemical formulations;
    - Dispensing technology;
    - Support programmes;
    - Training; and
    - Occupational health and safety and regulatory compliance advice.

52. Whilst a number of formulations are the same or similar, and some are required to be the same to meet customer and equipment specifications, there are over 300 different chemical formulations and over 10 dispensing systems.

53. The Commission is aware of the differentiation aspects noted above at paragraph 51 and has further addressed these characteristics at paragraphs 76 to 79. Nevertheless, the Commission maintains the I & I detergents and systems market is appropriate (refer paragraph 81).

54. Industry participants confirm that an I & I market definition is appropriate. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product market is the manufacture and supply of “professional” detergents, cleaning and hygiene products and systems to I & I customers.

Geographic Extent

55. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

56. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.

57. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.

58. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

59. The Commerce Act defines a market to be a "market in New Zealand". However, in many markets New Zealand buyers purchase products from both domestic and from overseas suppliers. Where imported products are close substitutes for domestic products, the overseas suppliers will be part of the relevant market. In such circumstances the Commission, in order to comply with the wording of the Act, is likely to define a national market and then, as discussed later in the competition analysis, to consider the extent to which overseas suppliers exercise a competitive constraint on the participants in the domestic market.

60. The Applicant has submitted that a national market is applicable in this instance, even though some suppliers confine themselves to regional areas. The main competitors sell nationwide. Industry participants agree that a New Zealand market is appropriate. Taylors Group Limited noted, from the laundry perspective, that it is a national market.

61. The Commission concludes that the geographical market is national.

Functional Level

62. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[3] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

63. The Applicant contends that the functional market is that for the manufacture and wholesale supply of I & I detergents. These are sold either direct to large end-use business customers, or through independent distributors. The distributors add I & I

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

detergent products to an extended range of janitorial and cleaning products to service the end-user with full cleaning package.

64. The Commission determines that the functional level is the manufacture and wholesale supply of I & I detergents.

The Timeframe

65. Generally, the Commission will view markets as functioning continuously over time. However, where a market is characterised by, for example, infrequent transactions, the Commission may seek to define a separate time dimension as part of its market definition process. Time considerations are also important where there are long-term contracts, and where there are depletable resources.

66. Time dimension is not relevant to the national market for the manufacture and wholesale supply of I & I detergents as transactions are usually frequent, and the resource is not depletable so long as raw materials can be obtained. There are some contracts in place between certain suppliers and purchasers, but they are relatively short-term being between one to three years in duration.

Conclusion on Market Definition

67. The Commission concludes that the relevant market is the national market for the manufacture and wholesale supply of I & I detergents and related systems.

COMPETITION ANALYSIS

Substantially Lessening Competition

68. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

69. Section 2(1A) provides that substantial means “real or of substance”. Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[4] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[5]

70. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[6]

71. While the Act defines the words “substantial” and “lessening” individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

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[4] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

[5] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [   ] 1 All ER 289.

[6] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

- The probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);

- The nature and extent of the contemplated lessening; and

- Whether the contemplated lessening is substantial.[7]

72. In considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

73. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

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

75. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[8] The I & I industry has known for some time that the DiverseyLever arm of the Unilever business has been for sale in a bid to reconsolidate Unilever's core business. If DiverseyLever is not sold to JWPNZ, it may be sold to another party although the Commission is not aware of any other interested parties at this stage. The Commission considers that the status quo is the most appropriate approximation for the counterfactual given the uncertainty of DiverseyLever's ownership in the absence of the proposed merger proceeding, and given the fact that the market is currently characterised by effective competition from existing participants.

76. The Commission therefore proposes to use the status quo as the counterfactual.

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[7] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [ ] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [ ] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.
[8] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

Potential Sources of Market Power

77. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

78. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one-year time frame.[9] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

79. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

80. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.

81. In the context of the I & I detergents market as defined, where price, product quality and service are taken into account by purchasers in choosing between I & I suppliers, the product is differentiated to a degree, and this has to be incorporated into the market analysis. However, the Commission considers that I & I products are not so differentiated as either to cast doubt on there being a single, well-defined, market for I & I detergents, or to warrant the special analysis associated with fully differentiated products.

Conclusion – Competition Analysis Principles

82. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the status quo.

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[9] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

83. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this Decision considers and evaluates the constraints that might apply in the I & I detergents market in relation to existing competition.

ANALYSIS OF EXISTING COMPETITION

Introduction

84. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

85. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.

86. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure that yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[10]

87. In determining market shares, the Commission will take into account the existing participants (including 'near entrants'), inter-firm relationships, and the level of imports.

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[10] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

This is followed by a specification of the Commission's 'safe harbours', an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

Existing Participants

88. There are a number of existing suppliers in the I & I detergents and systems market although, as noted above, Ecolab and DLNZ are the only market participants to provide I & I products across the full range of market segments. The other competitors listed in Table 1 focus on particular market segments of the I & I detergents and systems market.

Table 1:
Company Market Segment Operations

Company	Relevant Market Segment	Institutional or Industrial
JWPNZ	Housekeeping, Kitchen, Laundry	Institutional
DLNZ	Full range	I & I
Ecolab	Full range	I & I
Advance	Housekeeping	Institutional
Campbell	Housekeeping, Kitchen	Institutional
Jasol	Kitchen Food Hygiene	Institutional Industrial
Wilson's	Kitchen, Laundry Food Hygiene	Institutional Industrial
Orica	Food, Beverage, and Dairy Hygiene	Industrial
Fernz	Dairy Hygiene	Industrial

89. In particular, Ecolab is a vigorous competitor in the I & I products market, and on current figures, would hold a larger market share than the merged entity once combined across both the I & I market segments. Orica is the strongest competitor in the dairy hygiene segment and also competes in the beverage hygiene area, whilst Wilson's has a strong presence in food hygiene.

90. There are a number of other competitors operating in the market, which tend to be smaller operations that supply to small-medium sized businesses in specific regional areas. Clark Products Ltd, based in Napier, is noted as a vigorous competitor in the North Island region, and Qualchem Products is also well known in the Hawkes Bay region. Arnold Products Ltd in Hokitika focuses on South Island regions.

91. Participants at all levels advised Commission staff that the I & I detergents and systems market is aggressively contested.

Inter-firm Relationships

92. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.

93. The Commission understands that there are no formal or other relationships between the participants in the I & I market.

Imports

94. In markets where imports are present, the Commission will consider whether actual competition from imported products is the equivalent to that from domestic supply. In undertaking this evaluation, the Commission will take into account the existence of any limits on quantities of imported product (the price elasticity of supply), and the effects on trade of various factors. Imports channelled through the parties to an acquisition, or persons associated with them, will be added to their domestic production in assessing market share, rather than being treated as independent sources of supply.

95. Potential imports may also provide a constraint on domestic suppliers. This is considered as part of the assessment of the constraint from market entry below.

96. The Applicant estimates that approximately 70% of I & I detergents sold in New Zealand are manufactured locally. JWPNZ itself manufactures 90% of its products in New Zealand. Ecolab noted that 90% of the raw materials are imported and blended in New Zealand.

97. Industry competitors spoken to advise that competing product is readily available from overseas suppliers, but agreed that the high water content can make importation less attractive cost wise than local manufacture. The importation of powdered product was mentioned as a feasible alternative.

98. However, the cost of transporting heavy volume water over the Tasman from Australia to New Zealand is not stopping others from importing product into New Zealand. For example, E Sime & Co. Ltd in Wellington currently imports the Butchers range from Australia. According to the UCS Group, there are enough chemical manufacturers in the Auckland region without having to look at imports as an option.

99. Whiteley Chemicals Limited, a wholly-Australian owned company which already imports product into New Zealand through three agent companies, suggested that it, and Campbell Brothers, would move into the New Zealand market more vigorously in response to a 5% price rise by the merged entity.

100. The Commission accepts that an expansion in imports, if prices rise, is likely.

Safe Harbours

101. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

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

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

102. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

Market Shares

103. On the basis of the preceding discussion, the Commission proposes to use comparative annual sales figures as its primary measure of market share and concentration. The resulting shares are shown in Table 2.

Table 2:
Estimated National Market Shares for the I & I Market

Company	**Sales ($000)**	**Market Share (%)**
JWPNZ	[ ]	[ ]
DiverseyLever	[ ]	[ ]
Ecolab	[ ]	[ ]
Orica	[ ]	[ ]
Others	[ ]	[ ]
Total	**[ ]**	**[ ]**

104. The current three firm concentration ratio is [ ]. Post-merger, the three firm concentration ratio would be [ ] with the merged entity having a [ ] share. These figures are within the Commission's safe harbours.

105. Competitors spoken to by Commission staff agree that the total worth of the I & I market in New Zealand ranges between $100 million to $150 million. Adopting a conservative approach that the market is worth $100 million, the merged entity will have approximately [ ] of the market post merger. Again, this falls within the Commission's safe harbours.

106. As already noted, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include entry conditions; the presence of an aggressive, innovative or maverick firm; countervailing power of buyers or suppliers; rapid innovation in the market; and others. These are considered for the relevant market in subsequent sections.

State of Existing Competition

107. The acquisition would result in the merged entity becoming the second largest provider of the whole range of products within the I & I market (noting that Orica is larger, but predominantly focussed in the dairy hygiene segment). However, the merged entity would control only [ ] of the entire I & I market and would continue to face strong

competition from other participants in the market. Ecolab would remain the biggest provider of I & I products.

108. Participants spoken to believed they would be able to secure an alternative source of supply with relative ease in response to a 5% price rise by the newly merged entity. Most competitors, if not all, doubted that the merged entity would be able to raise prices 5% without other competitors from New Zealand and Australia moving to fill any supply gaps.

109. The capital outlay required to expand further into the I & I market is not thought to be particularly onerous. The applicant estimates that additional plant to produce 2 million litres of floor product would cost under $20,000. Industry participants confirmed that a $20,000 investment would enable an existing participant to produce a substantial amount of chemical product. An outlay of $20,000 might include $10,000 worth of tanks and fittings, different blenders, and additional storage required.

110. Currently, the I & I market is characterised by a number of large-scale contracts. A large proportion of JWPNZ's customers are on contract [ ], and over [ ] of Ecolab's business is on contract. Market participants note that a competitor needs a national presence to be able to secure a large contract (the hotel chains and the breweries for instance). The larger competitors tend to secure the contracts on the basis of their ability to fully service the client nationwide, and provide advanced technology and high quality product. In comparison, the smaller competitors tend to target the local markets and focus on the smaller industry contractors.

111. The length of contracts ranges between one to three years in most cases, depending on whether the supplier has to install special dispensing systems as part of the agreement. Although the Taylors contract, which is the largest hospitality contract worth [ ], was with Ecolab for the past 5 years, a contract of this length is not the norm. [ ] As the supplier, JWPNZ bears the cost of implementing all dispensing equipment. The nine sites are estimated to cost [ ] to install.

112. The contracts are not overly restrictive and are performance based. Customers can and do easily switch between suppliers at the expiration of a contract. The large purchasers spoken to note that it is easier to deal with a national supplier, but that they would look at the smaller competitors as an alternative if prices were unjustifiably raised.

Conclusions – Unilateral Market Power

113. The merged entity will be constrained by current competition.

Scope for the Exercise of Coordinated Market Power

Introduction

114. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are

involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

115. In broad terms, successful coordination can be thought of as requiring two ingredients: 'collusion' and 'discipline'. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination; 'discipline' requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

116. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

117. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

118. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 3. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the I & I detergents and systems market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse.

Table 3:
Testing the Potential for 'Collusion' in the I & I Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	No
Undifferentiated product	No, even though the basic chemical products are fairly standardised, there are over 300 formulations and 10 dispensing systems.
New entry slow	No
Lack of fringe competitors	No
Price inelastic demand curve	Mixed, a wide range of products, some essential products would have inelastic demand properties, but sales of other discretionary products are elastic.
Industry's poor competition record	No – no problems apparent.

Factors conducive to collusion	Presence of factors in the market
Presence of excess capacity	Yes, competitors could increase capacity if they desired.
Presence of industry associations/fora	Yes, but limited influence and membership spread.

119. Industry participants spoken to mentioned several associations including the Master Cleaners Association, the Building Services Contractors Association, the New Zealand Chemical Institute Council, and the Chemical Manufacturers Association. Most competitors spoken to noted that these associations are primarily used as an industry and regulatory information source. Whilst the associations are supported to some extent, there are no strong relationships between competitors within the industry. In particular, some purchasers and competitors emphasised that the big three multinational companies are fiercely competitive towards each other.

120. The assessment of the relevant structural and behavioural conditions in the I & I market in Table 3 suggests that the market is not particularly likely to be susceptible to collusion, even after the acquisition. As such, the Commission has found it unnecessary in this case to go on to determine the potential for discipline in the I & I detergents and systems market.

Conclusions – Co-ordinated Market Power

121. The Commission has determined that the scope for the exercise of co-ordinated market power in the I & I market would not be enhanced by the acquisition.

Conclusions – Existing Competition

122. The Commission considers that existing competition will alleviate any concerns of unilateral power being exercised by the merged entity.

123. Furthermore, the Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced by the acquisition.

124. The constraint from existing competition is sufficient to satisfy the Commission that the proposed merger would not have, nor would be likely to have, the effect of substantially lessening competition in the I & I detergents and systems market. It is therefore unnecessary in this case to discuss in detail the issue of potential competition, and other competition factors.

OVERALL CONCLUSION

125. The Commission has considered the probable nature and extent of competition that would exist in the market for I & I detergents and systems. The Commission considers that the appropriate benchmark for comparison is the status quo, in which the market is characterised by effective competition from existing participants.

126. The Commission has considered the nature and extent of the contemplated lessening. The proposed acquisition would not result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines.

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

128. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the national market for the manufacture and supply of I & I detergents and systems.

DETERMINATION ON NOTICE OF CLEARANCE

129. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by S.C. Johnson Commercial Markets, Inc, or interconnected body corporate, of the Diversey Lever Group business, which includes the shares and/or business of DiverseyLever New Zealand Limited.

Dated this 17th day of January 2002

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P R Rebstock
Deputy Chair