3.121. Architectural and decorative paints may be solvent or water-based. Water-based paints can be manufactured at plants designed for the manufacture of solvent-based paints. Indeed, the major manufacturers currently produce a combination of water-based paints and solvent-based paints at their various manufacturing sites. This suggests a high degree of *supply side* substitution between solvent and water-based paints.

3.122. On the *demand side*, solvent based and water based paints may be substitutes for many purposes, although the extent of substitutability is influenced by customer preferences. For example, solvent-based and water-based paints are both washable, although solvent-based paints have better washability. Therefore, customers for whom washability is a key requirement are likely to be willing to pay more for solvent-based paints than water-based paints. However, if the price of solvent-based paints rose by five per cent relative to the price of water-based paints, it is likely that some of those same customers would be willing to switch to water-based paints. In doing so, they would make a trade-off between washability and price. On the other hand, there is limited substitutability between water-based paints and certain specialist solvent-based paints such as varnishes and lacquers.

3.123. Architectural and decorative paints are usually labelled as suited for 'interior' or 'exterior' surfaces. This distinction is relevant on the *demand side* only as interior and exterior paints can be manufactured using the same production equipment. In general terms, the main difference between the categories is that many exterior paints are solvent-based and more durable and resistant to the elements. Interior paints are often water-based and produce a better finish. Nevertheless, exterior paints may be used for interior surfaces although this is not common practice. Most retail customers are likely to be guided by the product's labelling when selecting paint. Although trade painters are generally more aware of a paint's characteristics and less likely to be influenced by labelling, manufacturers' guides are still likely to be used.

3.124. All major architectural and decorative paint manufacturers supply both interior and exterior paints as *supply side* substitution is very high. It would seem, therefore, that interior and exterior paints are products within the same market.

Geographic Market

3.125. In relation to the geographic market, it should be noted with regard to the *supply side* that Taubmans operates a single manufacturing facility at Villawood in NSW. Paint is distributed throughout Australia from this site.

3.126. Wattyl presently operates nine manufacturing plants: three in NSW at Blacktown, Botany and Kogarah; two in South Australia at North Plympton and Devon Park; two in Victoria at Moorabbin and Footscray; and one each in Queensland and Western Australia. Details of these plants were provided in Chapter 1.

3.127. Dulux also operates six manufacturing plants: two in Victoria; and one each in NSW, South Australia, Queensland and Western Australia. The smaller manufacturers have one or two production facilities. Distribution is generally restricted to a relatively small geographic area around the site(s).

3.128. A manufacturer's locational decisions are likely to be influenced by the trade-off between economies of scale in manufacturing and freight costs. Taubmans, for example, seeks to offset higher per unit freight costs arising from national distribution with unit production costs which are lower than the industry average. Its production costs are lower partly because of economies of scale. Although the smaller manufacturers operate single plants, their current production levels and production costs do not make national distribution viable.

3.129. There is industry agreement that the brands of Wattyl, Taubmans and Dulux are recognised nationally. Advertising of these brands has a national focus. Consumers' awareness of the brands of the smaller manufacturers, as well as their advertising focus, is more limited.

3.130. On the *demand side*, national market shares are identified. However, there can be considerable regional differences in sales shares. For example, Taubmans' sales share in each of Queensland and New South Wales is higher than its share of national sales. Similarly, the regional sales shares of the smaller manufacturers are often quite different to their share of national sales.

3.131. In relation to the geographic market, the Commission recognises that the closeness of competition between the large and small manufacturers varies very substantially across regions that correspond approximately to state boundaries. This might be consistent with the existence of state markets. The Commission also notes that different pricing structures are maintained for different regions.

3.132. The Commission considers that the better view is that the relevant market is the national market for the manufacture and supply of architectural and decorative paint. However, regional variations in competition must also be considered.

3.133. The value of sales in the national market for architectural and decorative paint is estimated to be $550 million. Production is estimated to be 119 million litres. The Commission concludes that this is a substantial market for the purposes of section 50 of the Trade Practices Act.

4. The applicant's submissions

Wattyl

4.1. Wattyl has applied for authorisation of its acquisition of the Taubmans architectural and decorative paint business on the grounds that the acquisition will result in public benefits. The public benefits Wattyl claims as a result of the acquisition are business efficiencies, increased research and development expenditure, enhanced international competitiveness, return of Taubmans to Australian ownership, advanced environmental benefits, better health and safety procedures and increased competition in the relevant markets.

Efficiencies

Rationalisation

4.2. Wattyl has submitted that as a result of the proposed acquisition of the Taubmans architectural and decorative paint business Wattyl would be able to rationalise the following aspects of the business:

- manufacturing sites resulting in improved manufacturing efficiencies and economies of scale;
- warehouse and distribution facilities resulting in significant savings mostly through reductions in stock holdings;
- trade depots resulting in recurring cost savings;
- administration resulting in recurring cost savings;
- advertising and promotion resulting from economies of scale and cost savings.

Manufacturing sites

4.3. Wattyl currently carries out paint manufacturing processes in nine factories throughout Australia while Taubmans manufactures its architectural and decorative paint products at one site.

4.4. Acquisition of Taubmans by Wattyl would allow rationalisation from manufacturing sites to , resulting in extensive economies being available to Wattyl.

4.5.

4.6. The acquisition of the Taubmans Villawood site would enable Wattyl to quickly rationalise its manufacturing sites thereby achieving the efficiencies available from dedicated manufacturing, longer production runs, improved quality control and better raw material utilisation.

4.7. It is claimed that rationalisation of manufacturing sites would yield recurring annual savings of $ million per annum.

Rationalisation of warehouse and distribution facilities

4.8. While the manufacturing sites would be rationalised, it is intended that warehousing operations would be maintained in a number of States to maintain current high service levels to Wattyl's customers. However warehousing operations would be centralised.

4.9. The major saving is said to be the reduction in stock holdings in the order of per cent or approximately $ million. Interest saved on financing these stock holdings, assuming an overdraft rate of 10 per cent, would be approximately $ million per annum.

Rationalisation of trade centres

4.10. Following the acquisition Wattyl would operate 125 trade centres throughout Australia. It is intending to rationalise these trade depots with the closure of trade centres.

4.11. With the closure of trade centres the recurring annual saving to Wattyl from rent, rates, telephone/fax, freight, cleaning, etc (but excluding savings from reducing personnel) are estimated to be in the order of $ million.

Administration and office sites

4.12. There would also be a corresponding rationalisation of administrative functions and office sites with the rationalisation of manufacturing sites.

4.13. Total savings excluding those from reduced numbers of employees in this area is estimated to be $ million which will be ongoing.

Advertising and promotion

4.14. Wattyl currently spends approximately $ million on advertising and promoting its architectural and decorative paint products. It is understood that

Taubmans spends in the order of $ million on advertising and promotion. Wattyl have submitted that assuming both companies place their business at reasonably competitive rates it would still be realistic to expect that savings of   per cent in rates could be obtained.

4.15. On this basis it would be expected that the combined company would save $ million per annum on current expenditure.

Raw materials

4.16. Wattyl estimates that post merger its purchasing power for raw materials would provide economies of scale (including packaging) due to the increased volumes of raw materials required.

4.17. The estimated savings in raw material costs would be   per cent of purchases or $ million per annum.

4.18.

Employees

4.19. As a result of the acquisition there would be an amalgamation of many of the facets of the respective Wattyl and Taubmans businesses which would eliminate to a considerable extent the duplication of functions.

In addition other proposed rationalisations would allow the shedding of   positions within the current Wattyl workforce.

4.20. The total recurring annual savings are estimated to be approximately $ million. Of these saving, $ million would be attributable to the acquisition with a further $ million attributable to the ensuring rationalisation.

Efficiencies - result

4.21. Wattyl estimate overall that the recurring savings from the acquisition by Wattyl of Taubmans architectural and decorative paint business and the ensuing rationalisation would be $ million per annum. If, as claimed by the Commission, the combined business will sell 46 per cent of the architectural and decorative coatings in Australia, and on the basis that the current total cost to Wattyl and Taubmans of individually manufacturing and selling this paint is $ million per annum, then it can be said that the acquisition will reduce the costs of producing and marketing nearly half of the architectural and decorative coatings in Australia by approximately   per cent.

4.22. Wattyl submits that a substantial portion of the efficiency gains will be passed on to its retail customers through the normal competitive processes; and that any benefits retained by shareholders must also be regarded as public benefits. They note that a large number of Wattyl shareholders are Australian.

Research and Development

4.23. At the present time Wattyl spends approximately per cent of its turnover on research and development. The acquisition of Taubmans is expected to increase its turnover by $ million. This, it is submitted, given Wattyl's commitment on research and development will yield and extra $ million for research and development each year compared with Taubmans current expenditure of approximately $.

4.24. This extra $ million is proposed to be used to employ additional qualified staff and to finance co-operative projects with outside providers of specialised research and development.

International competitiveness

4.25. With a larger base in Australia Wattyl claims it would be able to accelerate developments in its overseas operations thereby increasing royalties and dividends repatriated to Australia. With the acquisition Wattyl expects to be able to commit additional resources to its overseas operations so as to make them more competitive enabling Wattyl to expand with an increased and improved product range.

4.26. Wattyl anticipate that these improvements in product range would be greatly enhanced by using Taubmans formulations and technology which are not currently available to Wattyl's domestic or international operations. To date Wattyl has expended significant resources for the development of interior broadwall paint for these markets. Given Taubmans' acknowledged expertise in interior broadwall paints Wattyl expect to be able to accelerate this development and launch new products more quickly than would otherwise be possible.

4.27. The acquisition and resulting efficiencies are said to increase the viability of exporting product to nearby foreign markets particularly New Zealand; and Wattyl intend to re-assess exporting opportunities after the acquisition.

Australian ownership

4.28. The proposed acquisition by Wattyl will return the Taubmans business to Australian hands. It is submitted that this will avoid profits from the business being repatriated to overseas or losses being claimed as a deductions by other profitable Courtaulds companies in Australia. Once the Taubmans business would be returned to profitability by Wattyl additional tax would be paid to the Australian Government and retained earnings invested by Australiansa for Australians.

4.29. The proposed acquisition is said to provide increased opportunities for Australians also to be promoted to senior executive positions in an enlarged Wattyl.

Environmental benefits

4.30. Wattyl notes that it complies with all relevant Australian environmental regulations and standards but believes that Courtaulds has adopted environmental standards for the Taubmans business which are in excess of the relevant Australian regulations and standards. The adoption on these standards would allow Wattyl to further improve its environmental controls to the benefit of the local environment.

4.31. Courtaulds is said to use advanced environmental practices at the Taubmans manufacturing site at Villawood which include extensive use of recycling so that there is no waste that has to be removed from the site as a result of the manufacturing process. Wattyl envisages that the environmental standards and practices adopted by Courtaulds at Villawood would be applied by Wattyl to its manufacturing sites thus providing a real environmental benefit and savings in terms of the cost of waste removal.

Health and safety

4.32. Wattyl believe that Courtaulds is well advanced in the adoption and implementation of world's best practice health and safety procedures. Wattyl believes that these procedures are most likely more rigorous than the standards presently required by legislation and regulations in Australia.

4.33. Any health and safety procedures adopted by Taubmans found to be superior to procedures currently in place in Wattyl's factories would be quickly implemented. It is anticipated by Wattyl that this would improve the working conditions of all Wattyl employees and result in important savings in terms of both human cost and compensation payments.

Pro-competitive benefit

4.34. The proposed acquisition of the Taubmans business by Wattyl is claimed to increase competition in the paint industry.

4.35. Wattyl submits that neither it nor Taubmans is currently able to offer retailers a full range of architectural and decorative coatings with national brand awareness. If the proposed acquisition is permitted Wattyl claims it would be in a position to offer such a full range of products to retailers.

4.36. Wattyl submit that the merger would result in an overall increase in research and development expenditure in the industry which would enhance dynamic efficiency and competition.

4.37. Wattyl has claimed that there are further reasons why the proposed acquisition would not be anti-competitive, including:

- retailers of paint have a high degree of countervailing power in relation to the negotiation of price;
- barriers to entry into the industry are not high;

- smaller manufacturers in regional centres and elsewhere have prospered over the last five years and prevent large manufacturers from increasing prices;
- imports are feasible and will become even more viable with lower tariffs and falling transport costs.

Taubmans

4.38. Courtaulds, Taubmans and Pinchin Johnson joined Wattyl in their application for authorisation of the sale by Courtaulds of the Taubmans architectural and decorative paint business to Wattyl. Courtaulds and its associated companies believe that the sale of the Taubmans business to Wattyl will not substantially lessen competition in the Australian market for architectural and decorative paint and will create significant public benefits which would not otherwise be likely to occur.

Significant increased export sales

4.39. Courtaulds submit that the Australian operations of multinational paint companies will never have the desire or support from their foreign parent to develop a truly international Australian paint presence. Wattyl is the only Australian owned paint manufacturer with an existing presence in international markets but is not a significant exporter and has developed only limited resources for its offshore business. The acquisition of the Taubmans business is said to provide a major boost to Wattyl's ability to develop significant offshore earnings.

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4.40.

4.41.

4.42.

4.43.

4.44.

Efficiencies and productivity

4.45. Courtaulds note that the acquisition of the modern Villawood plant of Taubmans will enable Wattyl to carry out the significant rationalisation of up to or Wattyl manufacturing sites, delivering major cost savings and efficiencies which would result in significant savings to Australian consumers.

Research and development

4.46. The merger of the Wattyl and Taubmans paint businesses is said to provide a more viable base to support the Australian development of leading edge technology for paint development. Without the development of a strong nationally owned paint manufacturer having access to economies of scale, Courtaulds submit that Australia would be restricted in its ability to support significant research and development in architectural and decorative paint.

Australian ownership

4.47. Courtaulds submit that the sale would provide major benefits to the Australian economy due to the future retention of the earnings and profits from the revitalised Taubmans business by Wattyl in Australia. Courtaulds state that it is its intention to strengthen its remaining Australian operations which would require capital expenditure; and that the sale of Taubmans would release valuable capital to Courtaulds which might be invested in its Australian industrial coatings business.

Environment

4.48. Courtaulds also considered that the Taubmans Villawood plant is a state of the art facility which would offer Wattyl significant improvements over Wattyl's current waste disposal systems, resulting in more effective treatment of waste management and emission reduction.

Health and safety

4.49. Similarly, Courtaulds submit that Wattyl would acquire the benefit of the international best practice health and safety systems adopted by Courtaulds worldwide, leading to an improvement in Wattyl's standards in that area.

Competition and Australian consumers

4.50. The acquisition is said to provide for an invigorated level of competition with Dulux. Wattyl would derive a number of key benefits from the proposal which would improve its competitiveness through costs savings, research and development and improved product range. Courtauld's view is that there would be competition between Dulux due to the low barriers to entry into the Australian market, the significant power of retailers, competition provided by smaller manufacturers, Dulux's track record of competitive behaviour and Wattyl's desire to expand its Australian business in conjunction with its international operations.

5. Market Information

5.1. The Commission has received information from several market sources in relation to the merger. These include submissions on the authorisation made by a number of interested parties, statements provided by Wattyl from 17 of its customers, affidavits obtained by the Commission for use in the s. 50 proceedings and market inquiries conducted by staff of the Commission both within and beyond the context of the s. 50 proceedings. Most submissions and all Wattyl statements were in favour of authorisation for various reasons. The deponents of the Commission affidavits were not in favour of the proposed authorisation; and the results of market inquiries were mixed.

5.2. The vast majority of market sources concurred on the following points:

- That both the trade and retail areas of the architectural and decorative paint market are highly competitive at present;
- That it is a mature market;
- That Taubmans products are of high quality;
- That in most regions Taubmans offers a good quality or at least competitive service, but that in some regions this has declined significantly in recent times;
- That Taubmans' competitiveness has been reduced by its failure over the last few years to adequately maintain the marketing and advertising (particularly television advertising) necessary to retain the strength of its brand;
- That this and other management decisions taken by Courtaulds have led to the current weakened market position of Taubmans;
- That the strength of the Taubmans brand and its market position can be restored by adequate investment in advertising and marketing;
- That the merger would produce a firm of at least similar size and strength to the current market leader, Dulux.

5.3. There is however a significant diversion of opinion as to other aspects of the proposed merger.

5.4. Many market respondents in their submissions considered that ICI/Dulux was dominant in architectural and decorative paint sales and that accordingly the merger was desirable or necessary to allow Wattyl to compete effectively with Dulux (eg. John Danks Pty Ltd ('Danks'), Department of Industry, Science and Tourism ('DIST'), Oldfields Pty Ltd, Programmed Maintenance Services Pty Ltd ('PMS') (and statement), Australian Owned Companies Association ('AOCA'), some market respondents). These respondents saw a merged Wattyl / Taubmans as the only possibility of providing real competition against Dulux.

5.5. A frequently stated cause of Wattyl's currently perceived inability to effectively compete with Dulux was that Wattyl does not currently have a complete product range, particularly in interior paints (eg. Mr Pomlett, Mr Cloy of Danks, Mr Barber, Mr Craig of PMS, Mr Burgmann and Mr King). Mr Barber also says that he uses the full range of Wattyl paints, and that one of the main features which has led him to use Wattyl is the range it provides. Similarly Mr Burgmann states that Wattyl cannot provide a full range but goes on to say that he stocks the full range of Wattyl interior and decorative paints, and that he selected Wattyl as his primary product in part because of the range it offers compared with Dulux, White Knight and Taubmans. Other market respondents currently use Solver products to complete the range (eg. Mr King, Mr Smith).

5.6. Mr Brennan says that Wattyl has a full range necessary to compete and is in fact competitive across its range. Likewise Mr Huston states that he stocks the full range of Wattyl products, and swapped from Taubmans to do so. The Commission's market inquiries indicate that Wattyl does offer a complete range, including interior paints, and that its premium interior brand, Ceramacoat, has been successfully launched. Indeed, Ceramacoat has already replaced the Taubmans Living Proof brand in the stores of a major Victorian retailing group.

5.7. Other anticipated pro-competitive benefits claimed by market respondents include the belief that Wattyl would achieve significant rationalisation benefits and pass these on to retailers or consumers (eg Mr Foote, DIST). Respondents claim that the merger would enhance Wattyl's service, and result in improved reliability such as Ms Wyper, who says she has many supply problems with Wattyl (although she has stocked Wattyl paint for ten years and continues to stock it). Ms Wyper believes the merger would make Wattyl 'far more reliable'. Dulux has been generally said by most respondents to have a reputation for good service, although many consider it "arrogant" in its dealings with its smaller customers. Mr Hale considered the merger would allow Wattyl to meet the advertising advantage currently enjoyed by Dulux.

5.8. Mr Carroll believes that the merger would improve the competitiveness of both Wattyl and Taubmans, and that their products are complementary. The merged firm, however, he considers would not be able to retain the combined market share after the merger that the respective firms currently enjoy. Mr Carroll also states that there was no rapid price increase after the Dulux acquisitions of Walpamur, Berger and British Paints, contrary to industry expectation at the time. APAS similarly believes this acquisition had no negative effect on competition.

5.9. All paint manufacturers believe there would be no price war following the acquisition. Major trade painters such as Gardner Perrott Property Services Pty Ltd ('Gardner'), the Higgins Group ('Higgins') and P&R Flood Pty Ltd ('Flood') also believe prices will increase after the merger. Others such as PMS did not. A number of retailers contacted are in favour of the merger because they believe it would help stabilise prices. None see it reducing prices. Some Wattyl customers, including Mr Anderson and Mr Smith, do believe prices will decrease as a result of the merger.

5.10. Market respondents including Mr Foote, Ms Wyper, Mr Barnsley and Mr Smith, believe that competition will be enhanced because Wattyl would inject the capital and/or management expertise necessary to reinvigorate the Taubmans brand, and that Wattyl would then allow it to run as a completely independent or autonomous competitive brand.

5.11. Cormack Group Pty Ltd ('Cormack'), suppliers of painting accessories to all the major manufacturers and retailers, sees no lessening of competition as a result of the merger, but considers they would gain efficiency savings in only having to service one company after the merger.

5.12. Many market respondents consider that Australian ownership of Taubmans would be of public benefit (eg. Oldfields, Mr Barnsley, Ms Wyper, Mr Scully, Mr Barber, Sydney University Polymer Centre, AOCA). These respondents anticipate a variety of economic benefits including an increase in jobs for Australians, additional research and development ('R&D') expenditure, import replacement and increased export opportunities (which would arise from greater efficiency, increased R&D spending, and achievement by Wattyl of the critical mass necessary to export successfully).

5.13. In essence the merger is seen by some respondents as leading to enhanced local and international competitiveness of Wattyl, and to an improvement in the balance of payments.

5.14. The Sydney University Polymer Centre and DIST both consider, based on their understanding of Wattyl's current and future intentions, that there would be more Australian R&D because Wattyl presently devotes a percentage of turnover to it, and that percentage would remain constant after acquisition. The increased turnover would therefore lead to a proportionate increase in R&D expenditure. The Sydney University Polymer Centre, which conducts research for Wattyl, notes that Wattyl currently possesses a 'genuine leading edge in R&D', that Australia is 'at the cutting edge' of research in this field, but that Wattyl needs a larger market size to fully exploit the potential of this research.

5.15. APAS considered that the merger would provide 'robust competition' between Dulux and Wattyl 'without seriously impairing the viability of smaller operators', but thought that the a merger of Dulux and Wattyl would be detrimental. It considered that if Taubmans were taken over by overseas owners, they might not appreciate the consequences of Australia's climate and consumer preferences, whereas Wattyl does understand these things.

5.16. Ms Wyper stocks only Australian owned products and thus considers the merger would allow her to introduce new products.

5.17. Most retailers that were contacted stated that they would pass any price increases on as they had little alternative. The more significant of the smaller manufacturers also indicate that their activities had little prospect of restraining a price increase by Wattyl and Dulux, after the merger.

5.18. Some retailers believed they had significant countervailing power at present. Mr Burgmann, says that although a marked increase in price would not be sufficient to cause him to change brands, he believes that it is not difficult to currently negotiate price decreases with Dulux, Wattyl and Taubmans. Mr Carroll believes he currently has sufficient power to play off various suppliers one against the other, as do Messrs. Woodman, Huston and Brennan. Messrs Woodman, Huston and Brennan believe that this power will seriously deteriorate post merger, but Mr Carroll and Mr Burgmann do not specifically deal with this issue, and are apparently not concerned.

5.19. Mr Carroll states that he would switch suppliers in response to an unacceptable price increase and many others said they would switch for a better overall deal. Mr Huston notes the costs and difficulties of changing principal suppliers. Mr Pomlett says that there is very little switching of products in his store, and he would rarely place a full range of new stock in store. Most market inquiry respondents thought that in the event of a post merger price rise, all lesser manufacturers would follow the price rise and thus their own competitive situation would not be significantly lessened.

5.20. Most retailer respondents considered they have very limited power now to restrain price increases by their current suppliers, and would be worse off after the merger as they would lose the ability to play the major manufacturers off against each other. They believe that the need to stock the products of at least Wattyl, Dulux or Taubmans and to offer a choice between these premium brands would significantly constrain their response. The reasons cited for the need to stock these brands include the strong consumer requirement for a well known brand; the need to offer a full range considering convenience, shelf space limitations and to attract volume rebates and other incentives; supply of tint machines, colour cards, samples and colour chips, point of sale material, training in sales and paint products which only larger companies provide; and the warranties of up to 10 years that the major manufacturers offered.

5.21. A leading paint specialist group also stated that to gain substantial trade custom, it is necessary to enter into a supply arrangement with Wattyl, Taubmans or Dulux and this was echoed in Commission affidavits. Some retailers found it possible to influence customers to switch to another of the well known brands, but only between well known brands.

5.22. Mr Burgmann, among others, considered brand 'extremely important', noting price, service and range also. Mr Carroll considered brand only of 'some importance' and that range, colour, price and availability were far more important. Mr Pomlett considered advertising and marketing of brand as critical. He said; 'There is very little switching of products in my store. I would rarely place a full range of a new brand in stock on the shelf however I might purchase specialised products from the niche section of the market. We have stocked Wattyl for 7 to 10 years and Dulux and Berger for the last 2 years. I would be influenced to switch brands by aggressiveness of a company to market themselves in terms of advertising and achieving consumer awareness and market. In my opinion a paint manufacturer could have the best paint in the world but if they did not actively market their product I would not stock them'.

5.23. Messrs Woodman, Huston and Brennan, and others, expressed concern as to their ability to switch major suppliers after the merger, because the remaining competitor would already have a sole distributor in the vicinity of their stores. They considered that, as a consequence, they would find themselves unable to obtain supply on competitive terms.

5.24. A number of the Wattyl respondents such as Mr Cloy noted the increasing importance of home brands, which have the potential to restrict the exercise of market power by the major firms because customers will either switch to home brands of their own accord or be influenced to do so by retailers for the better margins they offer. Mr Cloy noted however that product awareness and the need for quality were the most important factors in choosing which paint to distribute.

5.25. One Wattyl customer, Mr Foote, noted that 40 per cent of his sales were of home brand products. A stated benefit of home brands is that, as they can only be obtained from particular stores, the customer is more likely to return to that store to buy more of that particular product. However, market inquiries generally indicated that most customers perceive home brands to be of inferior quality, and that this is in fact largely accurate, because fewer key ingredients and ingredients of lesser quality are used in their production.

5.26. Existing home brands are manufactured almost exclusively by Wattyl, Dulux or Taubmans. An exception is Masterstroke, a trade line paint manufactured for Mitre 10 by White Knight. White Knight also manufactures New Look for the Paint Place Group. All smaller manufacturers contacted other than Haymes indicated that they were either uninterested or unable to tender for home brand contracts because they could not meet the volumes required, offer the storage facilities necessary, or carry the cost of manufacturing and store very large quantities of paint until required, nor meet the requirements of some home brand owners to provide promotional and advertising support for these products. Haymes' tenders have not been successful to date.

5.27. Other market respondents thought the market perception of home brand products so poor that they did not stock them. Bunnings and BBC also uphold premium brand strategies because of their perception of consumer acceptance of home brands.

5.28. Many respondents advised that they did stock a home brand, but only as a budget paint to supply consumers who did not require longevity or quality of the product, and that they would not supply this to a customer who required a premium paint. One of the Wattyl witnesses stated that the home brand it sold was of good quality, and that the company was prepared to warrant it by replacement if faulty.

5.29. Several trade painters advised that any price increase or diminution in terms would have to be passed onto the customer. A number of the largest firms, such as Gardner and Higgins, stated that they had very little countervailing power and would have to absorb or pass on the increases.

5.30. Trade painters generally indicated that the need for quality, volume discounts, technical support and warranties, as well as the specification of particular brands by customers or architects, require them to use major brands.

5.31. Trade painters offered varying views as to their ability to influence the brand choice of their customer. Some trade painters, such as Flood, considered they could influence some customer decisions between major suppliers. Others considered themselves bound by specifications, particularly for commercial jobs (eg. Ms Wyper, Mr Bradley) but relatively unconstrained for domestic jobs, where the customer would accept and rely on their recommendation. Some (eg. Mr Scully, Mr Barker) were relatively unconstrained in commercial work. Mr Craig of PMS said his company had complete freedom to use whichever paint it chose. None of the trade painter respondents used significant quantities of other than Wattyl, Dulux, Taubmans or Bristol products.

5.32. Some trade painters (eg. Gardner) stated that a further reason why major manufacturers needed to be stocked was because it was necessary to use one brand for an entire project in order to negotiate warranties and be able to rely on them. Many of the statements submitted by Wattyl (eg; Mr Barnsley) are from trade painters who state that they freely use different major brands on the same job, but did not specifically address warranty considerations, or the difficulties in proving which paint was at fault where a warranty was invoked. Market inquiries suggested manufacturers would not warrant jobs where brands were mixed, that is, where undercoats, primers or finishing coats of other manufacturers were used in conjunction with their own product.

5.33. Whilst a number of trade painters thought they could switch brands, none considered that they could switch to other than Wattyl, Taubmans, Dulux or Bristol. Bristol was regarded as a potential future supplier in some states, but was thought to lack quality service, brand recognition and consumer acceptance by a number of trade painters (eg; Gardner, Ms Maurer, Flood). It was also said to be rarely specified (eg; Ms Maurer and Flood).

5.34. Mr Scully notes that Haymes may be a competitive force in trade in a few years time, although he does not use it. He believes other small manufacturers provide vital competition, but notes price, quality, a full range of interior and exterior paints, and the ability to have supply on very short notice as essential requirements. He does not nominate which small manufacturers meet those requirements.

5.35. Mr Bradley notes brands can be important to customers but that manufacturer back up and support, quality, price and availability are more important to him. He believes that Haymes and other manufacturers in niche or home regional markets are a reasonable force in the Victorian market, although he uses only Wattyl, Dulux and Bristol products himself.

5.36. Most of the Wattyl customers believe that small manufacturers will exert a sufficient constraint on Wattyl/Taubmans and Dulux to prevent them exerting power in either price or non price areas after the merger. It is not clear (when the same respondents state that Wattyl and Taubmans at their current size, with their current range and current levels of advertising and marketing, are unable to sufficiently constrain Dulux from dominance) why the small manufacturers are said to be in a position to do so either now or post merger.

5.37. Small manufacturers themselves, in response to market inquiries, have indicated that they do not believe they would constrain Wattyl or Dulux pricing after the merger, as they do not effectively do so now. They consider themselves extremely vulnerable in a sustained price war, especially if that price war is conducted in their home or niche markets. The largest, Bristol, is not trading profitably under current market conditions. Bristol, Haymes and White Knight each consider that they will benefit as a result of the merger, but none expect to constrain prices after the merger.

6. Commission's assessment of effect on competition

6.1. The Commission shall only grant authorisation if it is satisfied in all the circumstances that the acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place: s. 88(9), s. 90(9).

6.2. The Trade Practices Tribunal concluded in *QCMA*, that it is appropriate to commence the assessment of public benefit with an assessment of the competitive implications of the proposed acquisition, for the following reasons:

> 1. A merger may positively enhance the competitive process and thus give rise to a substantial benefit ...
>
> 2. ... the benefits claimed may not mention competition .... Nevertheless, our appraisal of all the listed claims must depend upon our appreciation of the competitive functioning of the industry, with and without merger ...
>
> 3. A claimed benefit may in fact be judged to be a detriment when viewed in terms of its contribution to a socially useful competitive process ....
>
> 4. .... the substantiality of benefits needs to be measured against likely anti-competitive effects (and other detriments).
>
> 5. Quite generally, the Tribunal's role is seen as forming one of the means of achieving the policy objective of the Act, namely the preservation and promotion of useful competition.[15]

6.3. This chapter explains the Commission's views as to the likely effects of the proposed acquisition on competition. The following chapter evaluates the claimed public benefits that are likely to result from the acquisition.

6.4. The concept of competition in the Act is generally well understood and has been explained in decisions of the Courts and the then Trade Practices Tribunal.[16] The Tribunal said:

> Competition is a process rather a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate. The elements of market structure which we would stress as needing to be scanned in any case are these:
>
> (1) the number and size distribution of independent sellers, especially the degree of market concentration;
>
> (2) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market;
>
> (3) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion;

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15 QCMA, op cit, pp. 176,244 - 17,245

16 Now called the Australian Competition Tribunal.

> (4) the character of "vertical relationships" with customers and with suppliers and the extent of vertical integration; and
>
> (5) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities.
>
> Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct.[17]

6.5. This has been endorsed by the Federal Court in a series of cases: *TPC v Ansett Transport Industries (Operation) Pty Ltd & Ors*[18] ; *Adamson v West Perth Football Club Incorporated*[19]; *Outboard Marine Australia Pty Ltd v Hecar Investments (No 6) Pty Ltd*[20]; and *TPC V Australian Meat Holdings Pty. Ltd*[21].

6.6. For the purposes of authorisation, the Commission is not required to determine whether the acquisition would be likely to substantially lessen competition in breach of s.50 of the Act. Nevertheless, s. 50, and the procedures adopted in the Commission's *Draft Merger Guidelines*, are a useful framework for assessing the likely effects on competition of the proposed acquisition. Furthermore, as there are ongoing Federal Court proceedings to prevent the acquisition from proceeding on the basis that the Commission considers it to be in breach of s. 50, it is clear that the Commission is of the view that the acquisition is likely to have the effect of substantially lessening competition. Accordingly, it is important to articulate the reasoning behind the Commission's view.

Previous legislative framework

6.7. Since January 1993, s. 50 of the Act has prevented mergers that would have the effect, or likely effect, of substantially lessening competition in a substantial market. This is similar to the substantial lessening of competition test contained in the original Act. However, that test was not restricted to substantial markets.

6.8. The original test was replaced in 1977 by the 'dominance test'. Under this test, mergers were prevented that would, or would be likely to, create or enhance a position of 'dominance' in a substantial market.

6.9. The term 'dominance' was not defined in the Act. Generally, however, the Courts' decisions indicated that a firm could not be said to dominate a market unless it could act independently in that market without the need to take account of the competitive reactions of actual or potential rivals, including imports.[22]

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17 *Re QCMA*, 1976, ATPR ¶40-012, p.17,246.
18 (1978) ATPR ¶40-071.
19 (1979-80) ATPR ¶40-134.
20 (1982) ATPR ¶40-327.
21 (1989) ATPR ¶40-932.
22 Johns BL, 1994, 'Threshold Tests for the Control of Mergers: The Australian Experience', *Review of Industrial Organisation*, 9:649-670.

6.10. The dominance test restricted the number of mergers that would be subject to the Act. For example, under a dominance test, it may be difficult to prevent a merger that creates or maintains a domestic duopoly even though such a merger may be likely to substantially lessen competition. Under the substantial lessening of competition test, such a merger would be subject to considerable scrutiny and may only be allowed to proceed if barriers to entry and/or import competition are low, or if sufficiently significant public benefits can be demonstrated through the authorisation process.

Present legislative framework

6.11. Following the recommendation of the Cooney Committee [23] in 1991, the competition test for mergers contained in s. 50 of the TPA was amended, from one proscribing acquisitions that are likely to result in dominance or enhanced dominance of a market to one proscribing acquisitions that are likely to have the effect of substantially lessening competition in a market. This amendment took effect from 21 January 1993.

6.12. In recommending the changed test, the Cooney Committee made the following observations:

[23] Senate Standing Committee on Legal and Constitutional Affairs, *Mergers, Monopolies and Acquisitions: Adequacy of Existing Legislative Controls* (AGPS, Canberra, 1991)

> The philosophy underlying Pt IV of the Trade Practices Act is the protection and enhancement of competition. Implicit in Pt IV is the assumption that acts or occurrences which substantially lessen competition contravene the Act, unless authorised by the Trade Practices Commission on public benefit grounds.
>
> While most other conduct caught by Pt IV of the Act is subject to a competition test, s. 50 is subject to a less rigorous test. The existence of a dominance test in the area of merger regulation is difficult to reconcile with the essential thrust of the Act which is directed to preventing anti-competitive conduct.
>
> The dominance test was specifically introduced to facilitate the development of economies of scale in Australian industry, and to further its international competitiveness.
>
> However, the economic evidence, both analytical and theoretical, concerning the effects of mergers, presented during the course of this inquiry, has not led to absolute certainty. The economic evidence that mergers actually yield productive efficiencies remains equivocal. Nor it is clear that such efficiencies as have occurred have in fact improved the international competitiveness of Australian firms, or resulted in demonstrable benefits to consumers.
>
> A growing body of economic theory now suggests that international competitiveness, both in large and small nations, is achieved not by encouraging industry leaders to merge, but by encouraging them to compete. The work by Professor Michael Porter was frequently cited before the Committee. His studies of the development of national competitive advantage have questioned the view that domestic firms must be large relative to the size of the domestic industry to gain economies of scale in order to be internationally competitive. While Porter's work does not deal directly with Australian industries it nevertheless is a work of considerable importance by an internationally recognised authority in this area.
>
> The Committee also notes that a significant and growing number of Australian industries in the non-traded goods and services sector are not subject to international competition nor concerned with international competitiveness.
>
> Significantly, the dominance test where applicable internationally is often accompanied by a presumption of dominance at market shares of around 25 per cent or 33 per cent.
>
> The Committee considers that the essential thrust of the Trade Practices Act should be to prohibit acts which substantially injure competition, except where public benefit can be demonstrated. This principle is embraced elsewhere in Pt IV of the Act, and should also be incorporated in the merger regulation provisions.[24]

6.13. The Cooney Committee looked at a number of mergers that had not been challenged under the dominance threshold, but which were likely to have been challenged under a substantial lessening of competition threshold. These included the ICI/Dulux acquisition of Berger and British Paints.

6.14. In introducing the amendments to s. 50, the Attorney-General, the Hon Michael Duffy, stated:

> Merger control is an important element of any law aiming to preserve levels of competition. Mergers can lessen competition, potentially providing increased scope for price rises or collusive behaviour and lessening dynamic factors such as the rate of innovation. These possible detriments provide the rationale for government intervention in the area of mergers. On the other hand, mergers can be a valuable source of increased efficiency or other public

24 Dr Walker, J and Woodward L, 1996 *Ampol/Caltex Australia Merger: Trade Practices Issues* in "Trade Practices Law Journal" Vol. 4, No. 1, pp. 226-27

benefits. Such possible benefits require that a line be drawn between those mergers which are likely to be beneficial and those which are likely to be detrimental to the community as a whole.

For some time now, debate on the merger provisions has focused on where the line should most appropriately be drawn between acceptable and potentially unacceptable mergers. In its current form, s.50 prohibits mergers or acquisitions which create or substantially strengthen a position of dominance in a market, unless authorised by the Trade Practices Commission. Authorisation is available where there are sufficient public benefits to outweigh the anti-competitive detriments of mergers which would otherwise breach s. 50.

After much consideration the government has decided to amend s. 50 to prohibit mergers or acquisitions which are likely to substantially lessen competition and which have not been authorised by the Commission. In an Act which seeks to preserve competition it is appropriate that the merger test should focus on the effect on competition in a market rather than on the dominance of a particular firm. The effect of the amendment will be to broaden the range of transactions which can be examined under s. 50. This can only be pro-competitive.[25]

6.15. Competition is inhibited where the structure of the market gives rise to market power. Market power is the ability of a firm or firms to profitably divert prices, quality, variety, service or innovation from their competitive levels for a significant period of time. Firms with market power have discretion over their price and output decisions; competitive firms are compelled to perform by the discipline of the market.

6.16. Market power may be exercised either unilaterally by a single firm or co-ordinated among firms. The unilateral exercise of market power does not depend upon co-operation of other market participants. A firm with unilateral market power can assume that its rivals will behave competitively in response to price rises, but nevertheless their capacity to defeat a price rise is limited. By contrast, the co-ordinated exercise of market power depends on the co-operative or accommodating actions of other market participants.

6.17. Under the 'dominance' test the major goal of merger enforcement was to inhibit the acquisition or expansion of unilateral market power by a firm which would be in a position to dominate the market.

6.18. However, not all mergers that increased unilateral market power would have been prohibited by the test. In particular, markets for differentiated products will generally permit the exercise of some degree of unilateral market power by firms which are not dominant, but which have a large market share and strong brand loyalty. Mergers which facilitate a significant increase in the exercise of such market power would be considered to 'substantially lessen competition'.

6.19. In addition, mergers which are likely to facilitate the exercise of co-ordinated market power through explicit or tacit collusion, conscious parallelism or learned

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25 "*Trade Practices Legislation Amendment Bill 1992, Second Reading*", Weekly Hansard No. 15, 1992.

behaviour, would also be considered to 'substantially lessen competition', and hence breach the new s. 50 test.

Parties' views on the likely effect of the merger on competition

6.20. Wattyl and Courtaulds both argue that the proposed merger would enhance competition rather than lessen it. This argument is based on the view that Wattyl's and Taubmans' products are currently complementary rather than substitutes for one another. By acquiring the Taubmans' Living Proof range of interior paints Wattyl will be a more effective competitor for Dulux across the whole range of the premium end of the market. This means that retailers will have a choice of two suppliers (Wattyl/Taubmans and Dulux) of a full range of products instead of one (Dulux). The applicants views are supported by a number of other interested parties who made submissions to assist the Commission in its determination of this application.

6.21. The applicants have also submitted an economic assessment by Dr David Cousins[26] of the competitive effects of the acquisition, in support of their application. While the assessment does not really support the claim that the merger will be pro-competitive, Dr Cousins does conclude that competition is unlikely to be substantially lessened by this acquisition. These submissions and Dr Cousins statement are considered in more detail below.

Commission's assessment

6.22. It is necessary to consider a range of factors when assessing the competitive effects of a proposed merger. In this regard, Dr Cousins noted:

> The level of competition in a market will be influenced by the structure of that market. The number and relative size distribution of firms, ease of entry, extent of product differentiation, nature of vertical relationships and arrangements between firms have all been identified as important elements of market structure. The condition of entry is, however, considered crucial. It is also widely recognised that countervailing power can be an important element of market structure in some markets. Direct evidence of active rivalry between firms (conduct) is also important in assessing competition. Sometimes market structure and conduct evidence is inconclusive in establishing the competitiveness of a market. Evidence of market performance can be helpful in these circumstances.[27]

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[26] Associate Director of KPMG Management Consulting Pty Ltd.
[27] Dr Cousins, op. cit., paragraph 13.

6.23. The factors referred to by Dr Cousins broadly reflect the statutory merger factors set out in s.50(3) of the Trades Practice Act. In assessing whether a merger will substantially lessen competition in breach of s. 50 of the Act, s.50(3) provides that the Court must have regard to:

a) the actual and potential level of import competition in the market;
b) the height of barriers to entry to the market;
c) the level of concentration in the market;
d) the degree of countervailing power in the market;
e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
f) the extent to which substitutes are available in the market or are likely to be available in the market;
g) the dynamic characteristics of the market, including growth, innovation and product differentiation;
h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor;
i) the nature and extent of vertical integration in the market.

6.24. These factors, derived from extensive judicial and academic review of mergers, form the basis of the Commission's merger assessment procedures as set out in the Draft Merger Guidelines. The analysis below follows that approach.

6.25. The extent to which these factors are applied in assessing the effects of a merger on competition may be seen in their application by the Commission of the European Communities in its decision *Re the Concentration between Nestle SA and Source Perrier SA.*[28] In that instance the Commission gave the following reasons for its decision:

> a) it would create a duopoly with a combined market share of 82 per cent (by value) and 75 per cent (by volume);
>
> b) only the duopolists operated nationwide in the relevant national market;
>
> c) both operated in the most profitable segments of the market;
>
> d) no Community competitor approaching the size of either company existed;
>
> e) a major competitor, with the biggest capacity reserves and sales volume in the market, would be eliminated and its sources of supply and brands divided between the parties;
>
> f) the reduction from three to two national competitors would make anti-competitive parallel behaviour much easier;
>
> g) tacit co-ordination and pricing policies were facilitated by the fact that prices were transparent and the duopolists monitored each other's behaviour;
>
> h) the companies were similar in size with similar capacities and market shares;
>
> i) demand for the product concerned was relatively price inelastic;

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[28] *Re the Concentration between Nestle SA and Source Perrier SA*[1993] 4 C.M.L.R M17.

j) neither company enjoyed a significant cost advantage over the other;

k) the technology used in the industry was mature and research and development played only a minor role on the market;

l) product differentiation between the two companies would be increased;

m) the parties had acted together to deter the entry of a third party into the market;

n) firms operating at the local level did not constitute a significant competitive constraint;

o) high barriers to entry existed.[29]

6.26. A similar approach has been adopted by both regulatory agencies and the courts in the US and Canada.

Market concentration: s.50(3)(c)

6.27. Market concentration refers to the number and size of participants in the market. A concentrated market is a necessary but not sufficient condition to enable the exercise of market power. If the relevant market is properly defined, a firm or firms will not normally be able to exercise market power in the absence of a significant market share.

6.28. A merger which increases the level of concentration in a market may reduce competition by increasing the unilateral market power of the merged firm and/or increasing the scope for co-ordinated conduct among remaining competitors.

6.29. The 1992 United States Justice Department Merger Guidelines state that the principal concern of merger policy is that mergers increase the opportunities for firms to co-ordinate their activities, especially pricing. The Justice Department Guidelines state that:

> The unifying theme of the guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time. ... in some circumstances, where only a few firms account for most of the sales of a product, those firms can exercise market power, perhaps even approximating the performance of a monopolist, by either explicitly or implicitly co-ordinating their actions.[30]

6.30. The unilateral exercise of market power requires that a firm has sufficient control of the market, such that it can profitably 'give less and charge more' without being threatened by competing suppliers. For undifferentiated products this normally requires that a firm control a substantial portion of capacity. For differentiated products, brand loyalty and related factors may further inhibit smaller rivals from successfully preventing the unilateral exercise of market power. Market shares will generally be a good indicator of consumer preferences and brand loyalty for a firm's products.

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29 Ibid., p. M18-M19, [119]-[131].
30 United States Justice Department Merger Guidelines, 1992, para S-3.

6.31. A reduction in the number of firms operating in a market increases the scope for co-ordinated conduct, including both overt and tacit collusion. It becomes easier to reach agreement on the terms of co-ordination, to signal intentions to other market participants and to monitor behaviour. More even market shares may increase the commonality of interest between market participants in some circumstances. In other situations, the creation of one firm with a large market share may increase the likelihood of price leadership.

6.32. These consequences were clearly recognised by Circuit Judge Posner in *Hospital Corp. of America v Federal Trade Commission*[31] when he stated:

> The reduction in the number of competitors is significant in assessing the competitive vitality of the .... market. The fewer competitors there are in a market, the easier it is for them to coordinate their pricing without committing detectable violations of section 1 of the Sherman Act, which forbids price fixing. This would not be very important if the four competitors eliminated by the acquisition in this case were insignificant, but they were not; they accounted in aggregate for 12 percent of sales of the market. As a result of the acquisitions the four largest firms came to control virtually the whole market, and the problem of coordination was therefore reduced to one of coordination among these four.[32]

6.33. The Commission of the European Communities in its decision *Re the Concentration between Nestle SA and Source Perrier SA* also accorded weight to the consequences of a reduction in the number of competitors. It said:

> The facts and market structures show, however, that the French bottled water market is already a highly concentrated market where price competition is considerably weakened. ... Any structural operation restricting even more the scope for competition in such a situation has to be judged severely. The combination of the market structure arising from the merger and of certain additional factors lead to the conclusion that the proposed merger would have the effect of creating a duopolistic dominant position allowing Nestle and BSN to jointly maximise profits by avoiding competition among themselves and acting to a large extent independently of their customers and competitors.
>
> After the merger, the degree of concentration would be extremely high with Nestle and BSN holding over 82 per cent of the total French water market by value and 75 per cent by volume ....
>
> After the merger, there would be no competitor in the Community approaching the size, the range of well-known brands and the geographic spread of either Nestle or BSN.
>
> The reduction from three to two suppliers (duopoly) is not a mere cosmetic change in the market structure. The concentration would lead to the elimination of a major operator who has the biggest capacity reserves and sales volumes in the market. ... In addition the reduction from three to only two national suppliers would make anticompetitive parallel behaviour leading to collective abuses much easier.
>
> Given this equally important stake in the market and their high sales volumes, any aggressive competitive action by one would have a direct and significant impact on the activity of the other supplier and most certainly provoke strong reactions with the result that such actions could considerably harm both suppliers in their profitability without improving their sales volumes. Their reciprocal dependency thus creates a strong common interest and incentive to maximise profits by engaging in anti-competitive parallel behaviour. This

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[31] [1986-2] Trade Cases ¶67,377.
[32] Ibid., p. 61,990.

situation of common interests is further reinforced by the fact that Nestle and BSN are similar in size and nature ...[33]

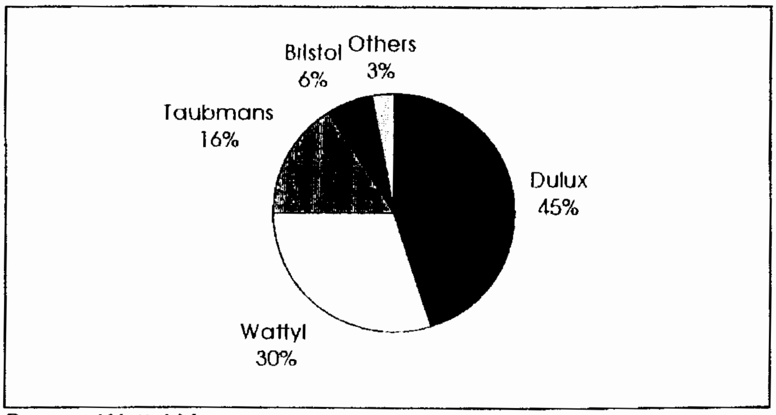
6.34. The Monopolies and Mergers Commission (UK) took a similar view in its report on the merger situation between *Bond Helicopters Ltd and British International Helicopters Ltd*:

> ..In such a market with only two suppliers the customer who is dissatisfied with the performance of his current supplier can turn only to one other, who can be expected to be fully aware of the circumstances. The customer will not be in a happy bargaining position. Both Bond and Bristow told us they would continue to compete vigorously. It seems to us, however, in the circumstances of this market, that the two players, both efficient and operating within the same constraints, and each with about half the market, are unlikely to compete strongly to detach market share from one another, knowing that the result is likely to be lower prices and lower returns for both. In such circumstances we would expect the two remaining competitors to have the power to set prices and for each to exercise price leadership in the geographic sector in which it is the market leader. As a result, we would expect prices to drift upwards to levels higher than would otherwise obtain, unless they were constrained either by customer buying power or the prospect of new entry, as Bond argued they would be. In reaching this view we noted that, although most customers saw little danger that standards of safety or service would decline, almost all were concerned about the effects on prices if the acquisition were allowed.[34]

6.35. Figure 6.1. shows estimates of market shares based on value. It indicates that Dulux is currently the market leader with a share of 45 per cent, followed by Wattyl with 30 per cent and Taubmans with 16 per cent. Bristol represents around 6 per cent, while a large number of smaller manufacturers and imports represent the remaining 3 per cent.

6.36. Estimates of market share by volume are shown in Figure 6.2. These figures are a composite of annual production figures provided by the major market participants and a total market estimate provided by the Australian Paint Manufacturers' Federation Inc.

Figure 6.1.: **Market shares by value (1995) pre acquisition**

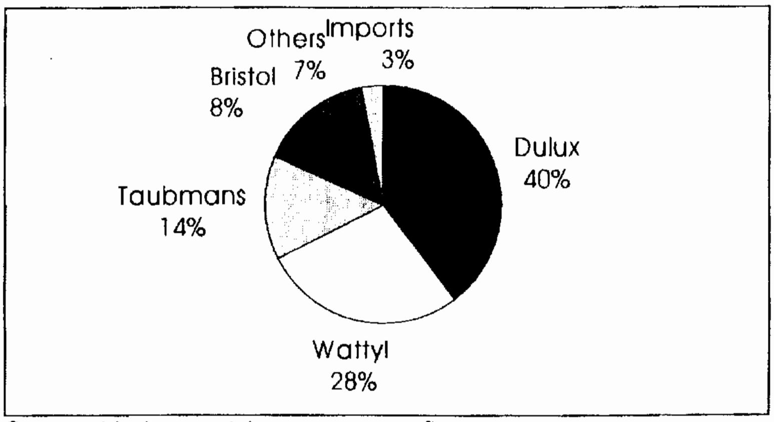


Source: Wattyl Management estimates 1994-95

[33] *Re the Concentration between Nestle SA and Source Perrier SA*, op. cit., p. M59-M61.

[34] Monopolies and Mergers Commission, Bond Helicopters Ltd and British International Helicopters Ltd, A report on the merger situation, September 1992, Cm 2060, HMSO, p.59.

Figure 6.2.: **Market shares by volume (1995) pre acquisition**



Source: Market participants - current figures

6.37. The three major manufacturers account for around 82 per cent of sales by volume. Bristol represents around 8 per cent while the smaller manufacturers each represent less than 3 per cent of the market and in total account for around ten per cent of volume sales. The figures confirm the industry rankings based on markets shares by value. However, each of the major's volume market share is lower than its corresponding value share. This implies that the unit value of the smaller manufacturers is lower than that of the majors.

6.38. Dulux is the market leader with 45 per cent of the market by value and 40 per cent by volume. There is disagreement in the evidence submitted by the parties as to whether Dulux is dominant. The applicants' economic advice, for example says that at the manufacturing level the evidence is that no one firm is dominant.[35] This contrasts with Wattyl who claim that the ICI/Dulux Group is dominant.[36] This disagreement appears to be fundamental. The applicants' economic advice argues that the smaller manufacturers have the most important role in constraining the conduct of the larger manufacturers. In contrast, Wattyl's argument rests on the inability of smaller manufacturers to constrain Dulux's conduct and the need, therefore, for a merged Wattyl/Taubmans to provide more effective competition to the market leader.

6.39. The differing approach becomes clearer when contrasting the applicants' economic advice that the merger *could* enhance post merger competition between Wattyl/Taubmans and Dulux, to the claim of the applicants that it *will* enhance competition. The economic advice states no more than that competitive pressures on Dulux *could* be enhanced, but then does not go on to analyse whether the market circumstances would lead to that outcome. The economic advice rests on the analysis of the competitive constraint imposed by the smaller players and retail outlets. Wattyl and Taubmans on the other hand, having said that the merger is necessary to enable greater competition with Dulux, must implicitly accept that

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[35] Dr Cousins, op. cit., paragraph 14.1.
[36] Wattyl submission, p.iii.

smaller players are not a particularly strong competitive constraint. For Wattyl and Taubmans to assert otherwise would be to undermine their principal claim that the merger is necessary for without it Dulux will continue unchecked as the dominant firm.

6.40. There is clear recognition of Dulux as the leading company in the industry and at times industry participants refer to Dulux as dominant. However, it is not uncommon in many industries for industry participants to use the term "dominant" to refer to the market leader. That does not establish dominance in the technical economic sense of the term.

6.41. Table 6.1. shows market share by volume in each of 1986/87, 1988, 1990/91 and 1995. The figures show that since 1986/87 the combined market shares of the three major manufacturers has increased from 60.5 per cent to 83 per cent in 1995. This is partly a result of the acquisitions discussed previously. The figures also show that Dulux's market share rose approximately 13 percentage points following its acquisition of Berger and British Paint in 1988 but has since fallen back by three percentage points. Wattyl's market share has increased significantly since 1986/87. Furthermore, although Taubmans' share has fallen since 1990/91, it remains above the share it achieved in 1986/87.

Table 6.1: **Market share by volume (%) 1986 - 1995**

Manufacturer	**1986/87(a)**	**1988(b)**	**1990/91(c)**	**1995**
Dulux	30.9	43.0*	40.8	40.3
Wattyl group	17.4	15.0	19.2	28.4
Taubmans	12.1	15.0	18.2	14.3
Others	39.5	28.0	21.9**	17.0 ***

* Incorporates British Paints which was acquired by Dulux in 1988. I
**Incorporates Bristol 6.7% and Crowhurst 4.9%
*** Incorporates Bristol 8.4%; Crowhurst was acquired by Wattyl in 1994.

Source: a - PSA Report into the Paint Industry
b - McCaughan Dyson Capel Cure Research Paper, May 1988, in Wattyl Submission
c - Wattyl Submission

6.42. Table 6.2. shows the market shares by value for each of the relevant regions:

Table 6.2.: **Market shares by region (%)**

Region	Wattyl	Solver	Pascol	Total Wattyl Group	Taubmans	ICI / Dulux	Bristol	Other
NSW	18	3	12	33	16	45	4	3
Vic/Tas	22	2	0	24	12	51	11	2
Qld	13	5	0	18	26	43	8	5
SA & NT	23	40	0	63	3	31	1	2
WA	18	14	4	36	13	49	0	3
National	18	8	4	30	16	45	6	3

Source: Wattyl Management estimates
NB: Tables may not add up to 100 due to rounding.

6.43. The Table 6.3. shows the manufacturers' shares of the segments of the architectural and decorative paint market. These figures are based on total production quantities for each company on an annual basis.

Table 6.3.: **Volume shares of architectural and decorative paint segments (%)**

Company	Interior	Exterior	Wood Finishes	Preparatory
ICI/Dulux	44	37	20	26
Taubmans	17	15	13	26
Wattyl	17	27	30	25
Bristol	13	10	5	7
Others	9	11	32	16

Source: Information Memorandum

6.44. The Commission is inclined to accept that Dulux is not dominant, and certainly not dominant in the sense in which that word was used in the old s.50 test, as interpreted by the Courts. The evidence does not strongly support the claim of Wattyl and Taubmans in this regard. Certainly Dulux's recent decline in market share does not support the proposition. Further, when we turn to consider evidence of actual competitive conduct in the market, there is ample evidence of vigorous competition on the part of both Wattyl and Taubmans as against Dulux.

6.45. The figures do indicate that Dulux is currently the market leader in interior and exterior paints. Wattyl is the market leader in the wood finishes segment while Dulux and Taubmans are joint leaders in preparatory paints.

6.46. In further support of the contention that the merger will be pro-competitive, Wattyl and Taubmans have claimed that their product ranges are complementary rather than directly competitive. The analysis contained in their economic advice in part has proceeded on this assumption and it is true that there is a widely held perception that Wattyl and Taubmans have strengths in different segments, respectively exterior paints and interior paints.

6.47. Yet it is evident that Wattyl and Taubmans do compete across the full range of architectural and decorative paint products, as against each other and as against Dulux. Taubmans and Wattyl hold similar shares of the interior paint segment. Taubmans' share of the exterior paint segment is less than that of Dulux and Wattyl but is not insignificant.

6.48. In any event, whatever view is taken as to the respective strengths of Wattyl and Taubmans and the degree to which they are competitive, it has not been suggested that they be considered in different markets. It is generally accepted that any analysis should proceed on the basis of their position within the broader architectural and decorative paints markets. In assessing market concentration, as required in this matter by s.50(3)(c), this has been the Commission's approach.

6.49. The Commission usually evaluates post-acquisition changes in market concentration using the four-firm concentration ratio (CR4). However, in a market with three large players and a number of much smaller players, there is little change in CR4 following a horizontal merger between any of the three large players. It is evident, however, that such a merger significantly changes market structure and the likely competitive outcome. To reflect this, the Commission has used the two firm concentration ratio (CR2) to analyse the impact on concentration of this merger.

6.50. If the proposed acquisition proceeds it will result in a substantial change in the structure of the architectural and decorative paint market in Australia and particularly in certain state regions, namely in Queensland, New South Wales and Victoria.

6.51. The acquisition will result in a substantial increase in concentration (in those market regions) as shown in Table 6.4.

Table 6.4: **Comparison of pre and post-acquisition two firm concentration ratios (CR2) based on value of shares**

Market	Pre-acquisition CR2	Post-acquisition CR2
New South Wales	78	94
Victoria/Tasmania	75	87
Queensland	69	85
South Australia/Northern Territory	94	97
Western Australia	84	97
National	75	91

Source: Derived by ACCC from Wattyl Management estimates

6.52. In the national market, the two leading suppliers would supply 91 per cent of the market by value compared with 75 per cent currently. Furthermore, the merger would result in the presence of two companies with similar market shares. Assuming no leakage of sales, Dulux would supply 45 per cent of the market by value and Wattyl/Taubmans would supply 46 per cent. (Even factoring in some market slippage, the proportions change very little). The next largest company, Bristol, would have a market share of less than one fifth the share of either of those two entities. Effectively, the post-merger market for architectural and decorative paint could be described as a duopoly.

6.53. This increase in concentration raises the likelihood that Dulux and Wattyl may independently recognise their interdependence and realise that for each to engage in price competition would be likely to result in a lowering of profits to each of them without any likely long term gain. The increase in concentration, therefore, increases the likelihood of cooperative behaviour in the market for architectural and decorative paint.

6.54. The applicants' economic advice refers to the question of price collusion and conscious parallelism. It recognises that in a market with only two major firms there will be a risk of conscious parallelism or price collusion; but states that for a number of reasons this will be lessened in this case. Four reasons are given:

1. the background, structure and strategic approaches of Dulux and the merged Wattyl/Taubmans appear to be quite different;

2. Wattyl/Taubmans and Dulux's products are differentiated, demand growth is unstable and excess capacity is persistent;

3. the presence of the prohibitions on anti-competitive conduct in the Trade Practices Act;

4. the competitive constraint imposed by small paint producers, new entry and imports.

6.55. Implicit in the above assessment is that the above factors are relevant to assessing the likelihood of conscious parallelism or price collusion. The Commission considers that an objective overview of all the evidence, including the internal documents of the applicants, show that all these factors are present in this case. Each of the last three factors will be discussed later. In respect of the first factor it is important to note that the key objective of this merger from the point of view of Wattyl is in fact to achieve a market compatibility with Dulux, in terms of costs, product range, market share and strategic approach. Therefore, the merger will significantly enhance the structural features of the market conducive to tacit collusion and conscious parallelism.

6.56. A reduction from three large firms to two makes the emergence of cooperative behaviour almost inevitable even if the firms do not consciously seek to cooperate. In such a situation, competitive uncertainty as to a rival's reactions is reduced substantially as each firm is easily able to monitor the activities of the other.

It may, however, take a period of experimentation to establish a cooperative outcome.

6.57. Wattyl correctly points out that there is not necessarily a nexus between concentration and competition. The Commission recognises that the likelihood of cooperative behaviour depends crucially on other structural features. In particular, it is likely to occur only if there is an absence of strong international competition and if barriers to entry are substantial.

6.58. Taubmans also disagrees with the Commission's view that the increase in concentration raises the likelihood of cooperative behaviour. It bases this argument on its observation that collusion is absent in other coating sectors such as the Packaging and Automotive OEM sector. While the Commission has not conducted an assessment of these sectors, the limited information provided by Taubmans suggests that there is at least one feature of those sectors which is likely to discourage cooperative behaviour. In particular, both sectors have relatively few customers. Therefore, the incentives to undermine any cooperative arrangement are strong. This is because an individual customer's purchases are likely to represent a substantial part of the revenue stream of a supplier. Consequently, there are likely to be significant payoffs in undercutting a competitor to gain market share. In comparison, the architectural and decorative paint market is characterised by a large number of customers such that no individual customer's purchases represents a substantial part of a supplier's revenue. For example BBC, one of the largest retailers of architectural and decorative paint, sells million litres of paint a year which is equivalent only to approximately per cent of the total market.

6.59. In addition, the work of Orr and MacAvoy[37], drawing on earlier work by Stigler[38] suggests that cartel prices may be stable where the detection of significant deviations from agreed upon prices is relatively easy. If deviations are easy to detect, they will tend to disappear over a short time as they are not secret and would invite a price cutting response by other firms in the market. Cartel pricing would be facilitated when the market is divided equally among several sellers. Tacit collusion would become stable.

6.60. More recent empirical work by MacAvoy[39] examined tacit collusion in the pricing of interstate long distance telephone services. MacAvoy found that when one firm was dominant, the best pricing strategy for its two competitors was one which would increase their market shares. The outcome of such a strategy would be that shares would become more equal as the price cost margins decreased. However, when the shares of the second and third firms increased to levels comparable to that of the first, price competition decreased and prices in the market converged over time at a higher than competitive level.

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37 Orr D and MacAvoy PW, 1965, 'Price Strategies to Promote Cartel Stability', *Economica*, Vol. 32, May, pp. 186-197.

38 Stigler G, 1964, A 'Theory of Oligopoly', *Journal of Political Economy*, Vol LXXXII.

39 MacAvoy PW, 1995, 'Tacit Collusion under Regulation in the Pricing of Interstate Long Distance Telephone Services' *Journal of Economics and Management Strategy*, Vol. 4, pp. 147-85.

6.61. MacAvoy's analysis has implications for the current matter. While his study took place in a market where regulatory restraints imposed a floor under the dominant firm's prices, it nevertheless showed that as service offerings and marginal costs of supply of each firm became more similar, the prices charged by the firms converged to a level above that which would occur under competitive conditions.

6.62. In a market of three firms where one firm achieves scale economies in production and distribution, much of the competition which exists in the market may come from the smaller second and third firms each trying to gain market share to achieve these economies. A merger of the second and third largest firms removes the rivalry at this level and thus removes the need for the largest firm to respond to the price competition of its smaller rivals.

6.63. MacAvoy concluded that when rivalry was intense, as indicated by decreases in concentration, price-cost margins were put under pressure but as market shares stabilised, price-cost margins increased substantially.

Import competition: s.50 (3)(a)

6.64. If import competition, or the potential for import competition, is an effective check on the exercise of domestic market power, it is unlikely that a merger will substantially lessen competition.

6.65. The Commission recognises that in some markets, market shares may understate the competitive restraint provided by imports because of the potential to expand the supply of imports rapidly in response to higher prices. This is often the case in commodity markets.

6.66. In other cases, market shares will overstate the likely role of imports in constraining the conduct of the merged firm. The fact that imports have established a small market share does not necessarily imply that they could expand in response to the exercise of market power by the merged firm. For example, imports may occupy a particular niche market, while the costs of importing may prohibit 'mass market' competition. Further, imports may be controlled by existing manufacturers who import to complement their domestic production. This is recognised by the applicants' economic advice where it is noted that most imports are speciality products and by existing manufacturers. In other markets, there is limited importing by wholesalers or retailers, but expansion may require significant investment in distribution facilities.

6.67. Import competition is a particularly important factor in the Australian context. Tariff protection has been substantially reduced in recent years and firms in many markets are faced with increased levels of import competition. In many markets, imports make up a large proportion of total sales. Importers may be able to increase sales rapidly in response to the exercise of market power by domestic firms because their Australian sales will often comprise only a small proportion of their total output. However, when there is no history of import competition and/or where transport costs amount to a substantial proportion of the product's value, the prospect of import competition may not be an effective constraint on the exercise of market power. In markets for differentiated or heavily promoted and branded consumer products, imports may face similar or greater difficulties to a new entrant in gaining market share. The potential for imports to effectively offset any anti-competitive impact of a merger is likely to be limited in such cases. Furthermore, if local producers are integrated into distribution, imports may not be an effective competitive restraint. A strong distribution system, independent of local manufacturers, is often needed if imports are to be any real constraint.

6.68. The information available to the Commission from the Australian Bureau of Statistics (ABS) in relation to the import of paints is for total paint imports including industrial paints such as marine or automotive paint as opposed to imports of architectural and decorative paints only. The only indication the Commission has of the proportion of architectural and decorative paints included in total paint imports is an estimate provided by Wattyl, suggesting that all water-based paint imports and 12.25 per cent of the volume of solvent-based paint were architectural and decorative paints in the most recent year. The Commission has not been provided with a methodology for isolating the value of architectural and decorative paints from the total value of paint imports. It notes, however, that the trends observed in total paint imports as measured by volume and value are reasonably consistent.

6.69. Between 1988 and 1995, the volume of total paint imports grew at an average annual compound rate of 6.9 per cent. This compares with average annual compound growth in:

- the domestic production of architectural and decorative paints of 4.2 per cent since 1991 (by volume);
- real gross domestic product of 3.0 per cent; and,
- real total Australian imports of 8.5 per cent.

6.70. The total volume of paint imports into Australia in 1995 was 7.5 million litres. By comparison, domestic production of architectural and decorative paints was 116 million litres in 1995.[40] Thus, imports of all paints including non-architectural and decorative paints into Australia were equivalent to 6.3 per cent of the domestic production of architectural and decorative paints. Based on Wattyl's estimate of the volume of architectural and decorative paints, imports comprised 2.9 million litres or 2.7 per cent of the architectural and decorative paint market in Australia in 1995. Given the small volume of current paint imports, it is reasonable to conclude that any likely future growth in imports of architectural and decorative paints will be from a very small base.

6.71. In the period since 1992, imports of solvent-based paints grew by 33.8 per cent while imports of water-based paints actually fell by 13.4 per cent. As architectural and decorative paints are predominantly, and increasingly, water-

[40] Australian Bureau of Statistics.

based, it may be reasonable to assume that the share of imports has not increased significantly since 1992.

6.72. Table 6.5. shows imports by country of origin of all paint in 1995 from the top ten countries. Imports from these ten countries account for 87 per cent of all paint imports, while imports from the top four account for approximately 60 per cent of imports. Paint imports demonstrate considerable instability, with substantial variations observed in the volume of imports between the December quarter 1994 and the December quarter 1995. This may reflect the influence of currency fluctuations on imports. Again, a breakdown of imports into the architectural and decorative category is not available. However, the parties refer particularly to actual and potential competition from New Zealand. Imports from that country represent 10.2 per cent of total imports of paint.

Table 6.5.: **Total paint imports by country of origin (top 10 countries), 1995**

Country of Origin	Volume (Litres '000)	Proportion of Total	Percentage change Dec Qtr 1995 compared to Dec Qtr 1994
U.S.A.	1 843	24.4	19.7
Germany	1 042	13.8	-32.9
New Zealand	766	10.2	130.9
U.K.	761	10.1	6.4
Netherlands	469	6.2	-28.4
Indonesia	398	5.3	1206.7
Italy	359	4.8	30.1
Greece	341	4.5	14.6
Belgium- Luxembourg	321	4.3	479.2
Japan	272	3.6	-56.9
TOTAL VOLUME	7 546	100.0	10.4

Source: ABS

6.73. The current level of imports is not sufficient to provide strong competition to domestic suppliers. However, the relevant consideration is whether imports could expand rapidly to defeat an exercise of market power by the merged firm. Tariff protection has fallen over the past few years. However, imports of architectural and decorative paint have not risen significantly in response. This suggests that there are other impediments to import competition which may constrain further growth.

6.74. In this regard, the Commission's inquiries suggest that transport costs continue to impede imports. Benjamin Moore has achieved short term success in supplying some product into the market but its ability to quickly expand imports appears to be limited given transport costs and the brand loyalty of existing manufacturers. Furthermore, Benjamin Moore's entry has been largely conditional on its ability to access the Your Local Paint Place resale outlets. For it to expand further, it would be necessary for it to extend its distribution network. This would be expensive and difficult to achieve given the vertical links that exist between manufacturers and resellers (see Chapter 3 and discussion on barriers to entry below). Similarly, imported paint products are unlikely to have a widely recognised brand. The need to establish such a brand in order to become an effective competitor, and the costs involved in doing so, are likely to constrain the ability of imports to expand quickly to deter or defeat an exercise of market power.

6.75. The Commission also notes that in the New Zealand market, which is the most likely source of imports, the major firms are ICI/Dulux and Wattyl. Their combined share of that market is around 50 per cent. It is unlikely that these firms would significantly expand imports to Australia in competition with their Australian businesses. In fact Dulux has a policy that precludes such competition.

6.76. Further, the internal records of Wattyl and Taubmans in relation to competitor activity in the industry shows very little consideration of imports as a competitive constraint. The impression that is gathered is that neither company sees imported product as a significant threat.

6.77. Thus, there is little evidence to suggest, and little reason to expect, that imports will rise substantially in the near future if domestic suppliers attempt to exercise market power.

Barriers to entry: s.50(3)(b)

6.78. Even if concentration is high and import competition is low, if the market is characterised by low barriers to entry, incumbent firms are likely to be constrained by the threat of potential competition to behave in a manner consistent with competitive market outcomes. However, if there are substantial barriers to entry faced by new suppliers into the market, or significant barriers to the expansion of smaller players in the market, a significant increase in concentration in the absence of significant import competition, is likely to give rise to a substantial lessening of competition.

6.79. Barriers to entry can be any feature of the market that places an efficient prospective entrant at a significant disadvantage compared with incumbent firms. They may consist of sunk costs; legal or regulatory barriers; access to scarce resources or cost advantages enjoyed by incumbent firms; economies of scale and scope; product differentiation and brand loyalty; and the threat of retaliatory action by incumbents.

6.80. The 'height' of barriers to entry indicates the extent to which incumbents can raise the market price above its competitive level without attracting entry. It is not necessary for a merger to raise barriers to entry for it to be anti-competitive; only that significant barriers to entry exist, providing incumbents with significant discretion over pricing and other conduct. If the merger also increases barriers to entry, the anti-competitive effects are likely to be more severe.

6.81. The Commission considers that effective entry is that which is likely to have a market impact within a reasonably short period, say two years; either by deterring or defeating the attempted exercise of market power by the merged firm. In some markets the threat of entry is sufficient to constrain firm conduct. In others, actual entry will be required. The latter would require entry on a sufficient scale and which offered a product sufficiently attractive to consumers to be effective.

6.82. Consistent with this view of effective entry is the opinion of the Commission of the European Communities in its decision *Re the Concentration between Nestle SA and Source Perrier SA* where it said:

> To address the question of potential competition it needs to be examined whether there exists competitively meaningful and effective entry that could and would be likely to take place so that such entry would be capable of constraining the market power of the two remaining national suppliers. The question is not whether new local water suppliers or foreign firms can merely enter by producing and selling bottled water but whether they are likely to enter and whether they would enter on a volume and price basis which would quickly and effectively constrain a price increase or prevent the maintenance of a supra competitive price. The entry would have to occur within a time period short enough to deter the company(ies) concerned from exploiting their market power.[41]

6.83. The economic advice provided to Wattyl and Taubmans appears to have adopted a different approach. This is clear from the applicants' economic advice where it is concluded that:

> Barriers to entry to the market do not appear to be high with recent cases of new entry and expansion by small firms testament to this. For example, Benjamin Moore, a large overseas paint manufacturer has recently entered the New Zealand market and has commenced to supply the Australian market through imports and through toll manufacturing arrangements with a smaller local firm. Asian Paints has entered the market in Townsville and Nippon Paints has commenced operations in Western Australia. Barriers to entry include the sunk costs required to develop brand reputation and access to retail shelf space. Capital costs of new plant are not particularly high. It has been suggested that a new entrant would incur at least $8 million to establish a plant of efficient size. (Affidavit of Ayman Adel Guirguis para. 80). I do not consider it appropriate, however to consider the capital costs of new entry on the basis of such minimum efficient scale plant. It is clear that smaller plants are quite viable in the market, especially when transport and distribution costs are taken into account.

6.84. However, the Commission considers that the potential for effective and substantial entry is the relevant approach. In determining whether effective entry is likely to occur, it is instructive to look at the evidence of past success or failure of new entrants to establish themselves as mainstream competitors in the relevant market.

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41 *Re the Concentration between Nestle SA and Source Perrier SA*, op. cit., p. M52.

Entry

6.85. Recent new entry to the industry has been limited. Over the past 10 years the only new manufacturing entry of which the Commission is aware, on the evidence before it, is Asian Paints (Queensland) Pty Ltd ('Asian Paints') which has recently set up a small manufacturing plant in Townsville. The Commission understands that its capacity is less than one per cent of current Australian production (capacity litres annum).

6.86. There have been isolated examples of new sources of paint supply through importation. In 1992 and 1993, for a period of approximately 18 months McEwans of Victoria imported between one and 1.5 million litres of housebrand paint from Levene in New Zealand. Importation ceased when McEwans was acquired by Bunnings Limited.

6.87. Benjamin Moore is currently supplying architectural and decorative paints from New Zealand. This paint is supplied exclusively to the Your Local Paint Place Group. The Commission is not aware of the volumes of paint that are being imported by Benjamin Moore. However, it is evident from the previous discussion of imports that the level is low.

6.88. It is evident that none of the above examples can be described as effective entry in the sense that they would be able to constrain the conduct of the merged firm.

6.89. Both Wattyl and Taubmans have pointed to Bristol as an example of a new entrant with capacity to expand. The Commission does accept that Bristol is not an insignificant competitor. However it is important to consider its position carefully, particularly as a new entrant.

6.90. Bristol Paints was established over 20 years ago. It began as a family owned company producing paint exclusively for sale within its distribution channel. It is now a wholly owned subsidiary of Lanes Limited ('Lanes'), a publicly listed company. Bristol operates a 100 store network of company owned 'Decorator Centres'. These stores sell only Bristol branded paint, a range of paint accessories and wallpaper. Bristol does not supply paint to other retailers for resale. Bristol's operations are limited to the east coast of Australia and it is operating .

6.91. An internal Courtaulds document entitled 'Bristol Paints' ('Bristol Report), dated 7 May 1993 describes the development of Bristol as follows.

> During the 1980's the company struggled within what was then described as a very difficult market, rapidly increasing its number of stores and earning a reputation as a paint discounter. Against this environment, the company became the target for a number of acquisition attempts, finally being acquired by Lanes... Under its new ownership, the company sought to move away from its price discounter image, and while reportedly successful initially, has reverted to being a major cause of low prices to the trade in all markets except its Victorian base.

6.92. Bristol is again subject to an takeover attempt by Thorley Industries Pty Ltd ('Thorley'), a subsidiary of Pratt Industries Pty Ltd, which has recently made a takeover offer for Lanes. Thorley issued a Part C offer for the issued shares of Lanes in April 1996 at an offer price of approximately $2.30 per share. This offer did not received any acceptances by shareholders. On 10 May 1996, Thorley increased its offer to $2.70 per share. However the Directors of Lanes recommended against acceptance of the offer. At the time of writing, the takeover offer was the subject of legal proceedings.

6.93. The Bristol Report indicates that, on being acquired by Lanes, Bristol undertook significant expenditure of multi-shaft dispensers and semi-automatic filling equipment at its manufacturing plants in Melbourne and Brisbane. The company also co-developed an instore colour matching system with Tikkurila Oy of Finland which now features in most of its Decorator Centres. Bristol also became a party to an international market intelligence collective which enabled it to monitor global architectural paint trends from which it developed the improved colour system.

6.94. Despite Bristol's efforts to advance its position as a leading paint manufacturer and retailer it currently accounts for only six per cent of the total national architectural and decorative paint market by value and 8.4 per cent by volume.

6.95. Bristol's profitability has also been quite modest over the past few years as demonstrated by the 1994/95 financial report for Lanes, which shows Bristol's total sales (paint, wallpaper and accessories) and operating profit between 1990/91 and 1994/95. Bristol's total sales have increased from approximately $45 million in 1990/91 to $71 million in 1994/95. After registering an operating loss of $10 million in 1990/91, the Bristol business recorded a $3.9 million operating profit in 1994/95. Profit levels have been approximately 5 per cent of total sales between the 1991/92 and 1994/95 financial years. Bristol's most recent interim results show that the business has incurred a loss of $190 000. It should also be noted that paint sales account for between 45 and 50 per cent of Bristol's total sales.[42]

6.96. Clayton Utz in a letter dated 7 May 1996, on behalf of Courtaulds, provided information about Bristol's current competitive position:

> As the ACCC may be aware, Lanes is currently the subject of a hostile takeover offer from interests associated with Mr Richard Pratt (ie: Thorley Industries). The Managing Director of Lanes, Mr Noel Terry, has elected to retire. Lanes is suffering significant uncertainty as to its own future and reported a loss in its paint business in its most recent annual results.
>
> The high risk for Lanes seeking to acquire the loss-making Taubmans business, and to turn it around, is likely to be unacceptable given Lane's modest financial position.
>
> ...Lanes is vertically integrated, with its Bristol decorator centres, thus competing as a retailer with the very retailers with whom Lanes would need to establish a relationship, if Lanes were to acquire the Taubmans business.

42 Wattyl submissions.

6.97. The above comments provide an important insight into the ability of Bristol to constrain the activities of Dulux and a merged Wattyl/Taubmans. As stated in the letter from Clayton Utz, Bristol is vertically integrated and does not currently supply retail paint customers such as BBC, Paint Place, etc. This is because Bristol and these retailers are in direct competition in the retail sale of architectural and decorative paint. Therefore, on Courtauld's assessment, there must be a real doubt as to Bristol's capacity or inclination to be an alternative supplier for these retailers post-acquisition.

6.98. It should also be noted that Bristol's operations are concentrated in Victoria and Queensland. On the trade side, which accounts for approximately per cent of total Bristol paint sales, Bristol would not be a real alternative for trade painters in NSW, South Australia, Western Australia or the Northern Territory, unless it substantially expanded its operations.

6.99. Finally, as noted above, Bristol is currently operating at .
Therefore any significant expansion of manufacturing would require Bristol to undertake additional capital expenditure for a new paint manufacturing plant. Taubmans suggest that Bristol have limited financial means, raising some doubt as to its financial capacity to undertake such an expansion.

Capital costs

6.100. The Commission received various estimates of the cost of establishing a viable paint manufacturing plant. Some estimates suggested that a company entering the market would need to capture at least 10 per cent of the market to be an effective competitor. This represents 10.7 million litres of product. The costs associated with setting up an operation of this size were estimated at $2.8 million for a 3500 sq. m. building and $2.5 million for the necessary equipment. The new entrant would also need a finished product warehouse of about 4 000 sq. m. which would cost approximately $2.7 million. Therefore total capital costs would be in the order of $8 million excluding land.[43]

6.101. Other estimates of start up costs ranged from $150 000 to $2 million.[44] However, expenditure of this magnitude would not enable a new entrant to fully exploit economies of scale.

6.102. The cost of establishing a solvent based manufacturing plant is higher than that for a water based plant of similar capacity. The former must be flame-proofed and the disposal of waste is subject to stringent controls.

6.103. These figures suggest that capital costs of establishing a manufacturing plant are not likely to be a significant barrier to entry. Furthermore, as noted earlier, small scale entry has occurred on a limited basis. However, a small entrant would experience difficulties in expanding to the scale needed to be an effective

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43 Wattyl submissions.
44 Taubmans submissions.

competitor. Large manufacturers are unlikely to respond to small scale entry. However, a strategic response from the incumbent firms is likely in response to an entrant seeking to capture a substantial market share, of say around 10 per cent of the market. Furthermore, there are other barriers to expansion that are discussed below.

Brand recognition

6.104. The importance of brand recognition in creating a firm's dominance in a market and potential barriers to entry has been recognised by the Courts. In the case of *Trade Practices Commission v Arnotts Ltd & Ors*[45] the Court said:

> As we see the evidence, it indicates five potential barriers to entry: the difficulties facing a competitor by reason of Arnotts' position as market (65 per cent share) and price leader; the capital cost which would be incurred by another organisation which sought to compete with Arnotts across a broad range; the strength of brand loyalty enjoyed by Arnotts; the competitive advantage ensuing from Arnotts' economies of scale and range; and the difficulty which a competitor would face in obtaining sufficient supermarket shelf space to support an "across-the-range" operation. The five matters are, of course, entwined.[46]

6.105. DIY painting is typically undertaken infrequently, around every five to seven years. Furthermore, the various qualities of paint cannot be assessed before the paint has been purchased. The earliest time at which the quality of paint becomes apparent is when it is being applied. Often, however, it may be quite some time after the paint has been applied before problems such as peeling are evident. If a paint's quality is inferior, it can often be costly to rectify. Therefore, DIY painters rely heavily on perceptions of quality and 'easy to understand' product information in order to achieve professional results. This includes written instructions and assistance from sales staff.[47] If a brand is unfamiliar, consumers might be unwilling to purchase that product because its quality is also unknown, or only purchase it at a significantly lower price.

6.106. Consumer behaviour is reflected in the behaviour of resellers in their attempts to convince consumers to purchase a particular product.

Nature of Brands

6.107. Wattyl claimed that brand recognition is not a significant barrier to entry and stated:

> Brand awareness which once was important is less important in today's market because of changes which have taken place in the retailing of paint over the last five years;

and

> Trade painters are less influenced by advertising and branding and are more aware of the qualities of the individual products.[48]

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[45] (1990) ATPR ¶41-061.
[46] Ibid., p.51, 790.
[47] Schafer Report, op. cit., p. 4.
[48] Wattyl submission.

6.108. These claims, and the impression they tend to create, are at odds not only with the market evidence and evidence from the internal records of the parties, but they are also at odds with Wattyl's stated intentions for undertaking the merger. Extracts from two documents prepared by Mr Boshell make this point most clearly.

6.109. In a document (provided by Wattyl through discovery) which is apparently an internal report to the Board of Wattyl, dated 14th July 1995, Mr Boshell stated:

> Company TT, or more specifically the architectural coatings division, has been put up for sales by its overseas owners.
>
> In the past Wattyl has believed that should this Company or its architectural division become available for acquisition, it would be advisable for Wattyl to attempt to acquire the Company. The main reasons for Wattyl's interest in Company TT is first, its acceptance in the retail broad wall paints market as an alternative supplier to Dulux. This acceptance is seen as the springboard Wattyl could use to quickly enter the retail broad wall paint market. In theory the use of the established TT brand would give Wattyl credibility as a broad wall paint supplier and the shelf space it otherwise would have to buy, almost certainly at low margins. The second, and probably more important reason, is the defensive one. If Wattyl does not acquire TT somebody else would. Wattyl would again become the third player in what is really a two participant market. Dulux dominates this market with TT, the only truly accepted national competitor. Wattyl has made some inroads but Dulux and TT have always been preferred, as they alone have been prepared to provide the advertising support essential for a National Brand. In many ways this cost of advertising has limited the number of competitors and enabled Dulux and TT to achieve reasonable margins. With Wattyl becoming increasingly prepared to finance its entry into this large market sector, margins have begun to erode. If Wattyl did not acquire TT this situation would continue as a non Wattyl ownership of TT would retain the status quo. However, if Wattyl did acquire TT it would gain a further 15.6 per cent of the architectural and decorative market and force any new competitor into Wattyl's current position of having to give not only lower prices but guarantee considerable National Advertising. On balance it appears Wattyl should actively pursue the acquisition of Company TT.

6.110. In a letter from Mr Boshell to Mr Luke Woodward, Senior Assistant Commissioner, Mergers and Assets Sales, dated 23 April 1996, Mr Boshell stated:

> Wattyl's decision to pursue the acquisition of Taubmans Architectural and Decorative business was based on the value the Taubmans brand would add to the Wattyl Group. Taubmans has a strong consumer following throughout Australia. The Taubmans brand has a high profile in both the retail and contractor segments of the architectural and decorative paint market. This brand recognition has been built up over many years. It is gratifying to see that even at the present time, when Courtaulds, the current owner of Taubmans, is actively seeking a buyer for the business due to its poor profit performance, the brand recognition in the market place remains high. It is this brand recognition that Wattyl sees as of great benefit to its future development. Wattyl and Taubmans products are complementary. Wattyl is known for its exterior finishes and niche products. Taubmans strength is its interior broad wall paints. The combined companies would form a total paint company that is ideally structured to challenge the dominant ICI/Dulux brands in the market place, a fact already evident in New Zealand where the acquisition of Taubmans New Zealand was completed on 1 December 1995.
>
> The strength of the merged company will be its ability to present to the consumer two quality brands. Wattyl for exterior and niche products and Taubmans for interior excellence. Each brand is of equal importance to the merged company. Wattyl will have to continue to grow both the Wattyl and Taubmans names if the merger is to achieve the benefits we believe are possible, based on our New Zealand experience. Significant investment, post acquisition,

will be made to return the Taubmans brand to its previous highly visible market position. The Taubmans products will be sold, into their rightful market place, the premium end of the retail market. This in turn will benefit contractor sales of the Taubmans products as their market visibility returns to its previous level.

6.111. The evidence, and the Commission's assessment, as to the significance of brand recognition in differentiating the products of the leading paint manufacturers from those of other manufacturers and also the particular difficulties of getting shelf access are discussed below.

The Importance of Brand Awareness

6.112. Within the architectural and decorative paint market, a particular paint brand may have national or regional awareness. Nationally recognised brands are generally supplied by the three major manufacturers and include the 'Wattyl', 'Taubmans' and 'Dulux' brands. Wattyl's nationally recognised brands are primarily in exterior paints while Taubmans are predominantly interior paints. Nevertheless, Wattyl does supply a range of interior paints while Taubmans supplies a range of exterior paints. Wattyl's apparent preference for acquiring a nationally recognised existing brand of interior paint rather than promoting its own existing brands suggests that there are significant advantages arising from nationally recognised brands, especially as Wattyl has stated that its Ceramacoat product (interior paint) is superior to others on the market.

6.113. Other brands are generally not recognised on a national basis but tend to have regional awareness. For example, awareness of the 'Bristol' brand is generally limited to the east coast of Australia. The awareness of the smaller manufacturers' brands is even more geographically localised. For example the 'Haymes' brand tends is not widely known outside of Victoria.

6.114. The existence of national and regional brands creates a high degree of product differentiation between the three largest manufacturers' products and those of their smaller rivals. The various national brands also differentiate the products of the three majors. However, the extent of this differentiation is less than that which exists between the major and minor manufacturers. Furthermore, each major manufacturer participates in each of the product categories, though some products are more successful than others.

6.115. The major strength of the market leader Dulux is considered to be a very high brand awareness for its various brands, which is achieved by 'an active promotional calendar' and 'advertising spending'.[49] Dulux's continued strength in terms of media and promotional spending is perceived as a major threat by Taubmans' management.[50] Dulux and other manufacturers consider one of Taubmans' major

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49 Retail Australia Report, op. cit.
50 Ibid.

weaknesses to be the reduction of marketing and promotion for their brand[51] resulting in reduced brand awareness.[52]

6.116. Brands provide a frame of reference within which consumers can make their purchase decisions. Brands have been promoted to convey information about quality. Taubmans' 'Living Proof' brand for example is associated with premium quality. If a purchaser recognises a brand, one he or she has been acquainted with at an earlier occasion, either by using it, by reference through friends or through advertising, the purchasing decision in favour of such a brand is facilitated. Consensus amongst the major retailers is that brand awareness is the most important factor when evaluating suppliers of architectural and decorative paint.[53] A report commissioned by Courtaulds comes to the following conclusions:[54]

> The consensus among the major customers in the three retail segments is that brand awareness is the most important factor when evaluating suppliers of architectural paint. Brand awareness is also closely tied to advertising and promotion of the products at the consumer level, as retailers prefer sourcing products which are nationally recognised for their quality. The customers seek a brand that is as popular in South Australia as it is in Queensland. This purchasing factor is important as customers seek to ensure that products can be purchased on a national level and consolidated centrally.
>
> Taubmans is rated lowest among the three largest suppliers in the retail market. Taubmans made recognisable cuts in its marketing and promotional funds and decreased its mass media advertising and promotion. There is a feeling among the customers that Taubmans lacks focus in its advertising and is unsure of its target customers. However, many customers believe that Taubmans' products are of good quality. In general, Taubmans needs to significantly improve its brand awareness by launching stronger advertising campaigns. Taubmans has been a player in the market for many years and most of the customers believe it will eventually improve its marketing and promotion of its products.
>
> While Taubmans has been cutting its advertising expenditures, both Dulux and Wattyl have been aggressively promoting their products. As a result, Dulux and Wattyl rank ahead of Taubmans in brand awareness. Dulux is rated the highest in brand awareness and is the most recognisable product in the Australian paint market. Dulux has launched a considerable advertising campaign to promote specific brands in the retail market. These national campaigns have helped Dulux establish the perception that its paints are the highest quality in the market. Retailers indicates that Dulux's brand awareness is "incredible" and that the product sells on its name alone.
>
> Wattyl has also been very aggressive in promoting its brands to consumers by focusing heavily on its "All Australian" image. Wattyl has very successfully promoted its products as Australian-made and promoted the company as Australian-owned. The customers believe that Wattyl has very successfully promoted this image even on its paint cans. Customers believe that this media campaign helped Wattyl unseat Taubmans for the second place position. Wattyl has strong name recognition because of its timber coatings products which most consumers view as a high-end product.

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51 Markowitz & McNaughton, Market Assessment Australian Architectural Coatings, presented to Courtaulds Coatings, May 1994, p. 27. (Markowitz & McNaughton Report)
52 Ibid., p. 28.
53 Ibid., p. 14.
54 Ibid.

6.117. Other surveys indicate that other important criteria for the choice of a supplier by a reseller are quality and value for money.[55] The perceptions with regard to quality and value for money are however often perceived to be synonymous with brand awareness.[56] While resellers consider the quality of Taubmans' products to be at par with the quality of Dulux and Wattyl[57] this does not translate into its rating with regard to quality and value for money by resellers and customers. Resellers rate Taubmans only second after Dulux with regard to quality and third with regard to brand awareness behind Dulux and Wattyl.[58] Retail customers' perceptions of the quality of a paint product correlates directly with that of brand awareness, Dulux, has the largest brand recognition and the largest advertising budget and is considered to be the best quality brand.[59]

Housebrands

6.118. A housebrand is a paint product which is specially branded for a particular customer by the paint manufacturer. Housebrand paints account for per cent and per cent of the total architectural and decorative paint sales of Wattyl and Taubmans respectively.[60] Estimates of the total volume share of housebrand paints in the architectural and decorative paint market vary from between 15 per cent to 20 per cent.

6.119. The following table shows the major housebrands and the supplier of that brand:

Table 6.6: **Housebrands by supplier and resellers**

Supplier	Housebrand	Reseller
Wattyl	Viva brand,	Mitre 10
	Colours of Australia,	PaintWise
	Home Brand and	Danks
	Thrifty Link	
Dulux	3D Brand,	3D Group
	Paint Place Brand,	Paint Place
	True Value brand,	True Value H/W
	Home brand,	K-Mart
	Home brand,	Big-W
	Hi-tech,	Paint Spot
	Painters Pot Brand,	Painters Pot
	Masterpaint,	Faraday & Kent
Taubmans	Accent,	Mitre 10
	Home brand,	Target
White Knight	New Look,	Paint Place
	MasterStroke,	Mitre 10

Source: Sale Makers, Wattyl and Taubmans submissions.

55 Holyman, Dart & Partners, Retail Paint Survey 1995. p. 28. (Holyman Dart Report)
56 Markowitz & McNaughton Report, op.cit., p. 16; Information Memorandum, op. cit., pp. 1, 11.
57 Ibid., p. 16.
58 Ibid., pp. 13, 28.
59 Business Development Group, Taubmans Decorative Coatings, Market Strategy Review - Discussion Document, May 1994, tables on retail end user - Key customer perceptions.
60 Wattyl and Taubmans submissions.

6.120. All of the housebrand paints identified above are manufactured by either Dulux, Wattyl or Taubmans with the exception of Mitre 10's *Masterstroke* and Paint Place's *New Look* which are manufactured by White Knight. It is not unreasonable to conclude, on the basis of this evidence, that resellers require their housebrands to carry the implied quality guarantee of the larger manufacturers.

6.121. The brand image of housebrands is consistently and considerably lower than the average of all other brands and even lower in the value for money category.[61] Although many resellers now have their own brands, these are perceived by consumers as lesser in quality than the premium brands.[62] This perception creates consumer resistance to housebrand paint, especially among DIY consumers who are unwilling to take a chance on unknown products. BBC stated in November 1995[63] that

Importance of brand in trade sector: Leading Edge Report

6.122. Trade painters require well known brands as end users often specify a particular brand for a project or at least require the assurance of a well recognised brand. Furthermore, trade painters generally require paint products which are supplied with guarantees against product failure. This guarantee is considered by many as a necessary element in competing for trade painting work.

6.123. Contrary to Wattyl's submission, the evidence does not support the proposition that brand is not important in the trade sector. For example, in 1993 Taubmans commissioned The Leading Edge Consultants to prepare a report on the Trade Paint sector.[64] The sample for the survey was 320 professional trade painters in NSW and Queensland. The following represent some of the findings of the survey:

Table 6.7.: **Brands used**

Main brand used	%
Dulux brands	33
Taubmans brands	24
Wattyl brands	25
Bristol	9
Others	9

Source: Leading Edge Report

6.124. The report concluded that 'Pascol (Wattyl), Taubmans, Dulux and Bristol command the strongest (brand) loyalty'.[65] The report also concluded that through incentive schemes new growth and representative relations, loyalty can be strengthened to encourage new growth and build upon present clientele.

61 Document entitled: Taubmans Brand Objectives; see also: p. 4.
62 Schafer Report, op. cit.
63 Interview with Mr Terry Jenkins, BBC Hardware, 21 November 1995.
64 The Leading Edge Consultants, 1993 Trade Paint Survey.
65 The report does not contain page numbers.

6.125. The most important factor in determining which paint was used was brand reputation as shown in the following:[66]

Table 6.8: **Factors in choosing paints**

Factors	%
Brand of paint	28
Type of paint	24
Price	19
Amount	15
Colour	7
Other	2

Source: Leading Edge Report

6.126. The report concluded that 'brand is a strong determinant of good and bad paint and it is important in the decision process'. Furthermore, the report found that 'brand reputation is of paramount importance (before price)' for professional trade painters.

6.127. The researchers also sought to gain some insight into the relative strength of the competing paint brands. Their findings are as follows .

Table 6.9.: **Leading Edge Professional Painters Survey**

	Berger %	Pascol %	Bristol %	Dulux %	Taub's %	Wattyl %	Home %
The best brand for interior paints	11	18	13	58	50	18	3
The best brand for exterior paints	11	13	11	59	44	34	3
An expensive brand	6	5	4	71	32	15	1
A high quality brand	11	13	11	70	48	25	2
A middle of the road brand	30	28	28	6	11	17	12
A brand with excellent service	7	17	18	41	43	16	3
A poor quality brand	7	12	14	2	3	5	38

Note: Totals exceed 100% as multiple responses were permitted; therefore the percentage figure relates to the number of responses of the sample group of 320 professional trade painters.
Source: Leading Edge Report

6.128. The above table indicated that the Dulux, Wattyl and Taubmans' brands were considered the best brands for interior and exterior use by most professional trade painters.

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66 The figures as given in the report and shown in this table do not add to 100.

6.129. It is noticeable that a large number of professional trade painters do not believe that either Bristol Paints or housebrands are high quality paints. This implies that such paints would be less likely to constrain any exercise of market power because trade painters would be less willing to switch to these lower quality brands in response to a SSNIP.

Advertising and promotion

6.130. The image conveyed by a brand is largely determined by advertising and promotional activities. Advertising expenditure shows a direct correlation to brand recognition which in turn influences sales and market share.[67] Taubmans slipped from second to third position with regard to market share when it cut back on advertising. Similarly brand awareness for Taubmans' products was reduced in the market place.[68] At the same time Dulux and Wattyl have consolidated or increased the brand awareness for their products and their market share through aggressive advertising campaigns particularly during the recession.[69]

6.131. The major promotional expenses are for advertising, colour cards, chips and brochures and on-site equipment as well as the provision of technical customer service through in-store support.

6.132. Advertising occurs in a range of media including television, radio and print. However television advertising is preferred by the major manufacturers and is essential for the support of a national brand.[70] National advertising helps to establish a quality reputation for a brand.[71] Because of its cost, few of the smaller manufacturers advertise on television.[72] They are thus restricted in their ability to develop national brand awareness.

6.133. Paint manufacturers also promote their products by offering technical and other support to resellers and consumers. Taubmans, for example, provides technical support to retail and trade resellers. It also operates a 'professional advisory service', which provides technical advice to professional painters.[73] Resellers are also increasingly demanding in-store service and support from manufacturers. This includes vendor refill/merchandise assistance and in-store training. Consequently, an effective sales force is becoming increasingly important for ongoing support of a brand at store level. Smaller manufacturers are rarely attractive to the national chains because they are unable to provide the service or brand awareness required by this group. As a result smaller manufacturers have tended to develop product niches in regional areas.

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67 Kennedy Rea, op. cit., Introduction.
68 Markowitz & McNaughton Report, op. cit., pp. 8, 9, 14, 30
69 Ibid., pp. 8, 9, 14.
70 See: Kennedy Rea, op. cit., Recommendation - "Television support during peak purchase periods is seen not as a bonus by the retailer, but simply as a cost of entry as a national paint supplier".
71 Salemakers Report, op. cit., p. 10.
72 Schafer Report, op. cit., p.22.
73 Information Memorandum, op. cit., p. 13.

6.134. The Commission understands that smaller manufacturers are often able to utilise the on-site equipment, such as paint mixers, that are provided to resellers by the large manufacturers. In this sense, the cost of entry is reduced. However, the fact that large manufacturers permit such free-riding is indicative of the weakness of the competitive restraint currently imposed by small manufacturers. Large manufacturers would be unwilling to permit other manufacturers access to their equipment if such access resulted in a reduction in prices. Furthermore, while the use of another manufacturer's equipment lowers the initial cost of entry, it will be necessary for a small manufacturer to eventually incur the cost of providing such equipment if it were to seek to expand.

Advertising Costs

6.135. The importance of brand awareness is reflected in the sums that are spent on advertising and promotional activities by paint manufacturers. The major suppliers have engaged in extensive television advertising and most major participants spend several million dollars in promoting and supporting their product each year. The extent to which smaller manufacturers can undertake such advertising and promotion is limited by the size of their business. In particular, there are economies of scale in advertising which mean that the smaller suppliers' use of electronic media to promote their products is limited.

<u>Taubmans</u>

6.136. Taubmans estimated that advertising constitutes approximately per cent of total marketing costs. Prior to recent reductions in advertising and promotional costs, Taubmans' marketing costs were around $ million per annum, including sales force salaries and running costs of trade centres. Of this, $ million was spent on advertising, colour cards and brochures. Taubmans spent approximately $ million annually on advertising its Living Proof Silk, which accounted for about a quarter of its production[74] and spent $ million on advertising and promotion in general.[75] This translated into approximately cents per produced litre (million litres per annum) of paint or per cent of sales ($ million per annum).

<u>Wattyl</u>

6.137. Wattyl's total advertising costs are $ million.[76] That means that Wattyl spends nearly cents per produced litre of paint (million litres per annum) on advertising or nearly per cent of its total sales revenue ($ million per annum). Wattyl has allocated an advertising budget of $ for its Solagard product, in the 1995/96 financial year.

<u>Dulux</u>

6.138. Dulux spends approximately $ million annually in promoting the "Dulux" brand alone and up to $ million on television advertising in total. Dulux spends a

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[74] Taubmans submissions.
[75] Wattyl submissions.
[76] Wattyl submissions.